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S. Hrg. 98-405

FAIR DEPOSIT AVAILABILITY ACT

HEARING

BEFORE THE

SUBCOMMITTEE ON CONSUMER AFFAIRS

OF THE

COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

FIRST SESSION

ON

S. 573

TO REQUIRE DEPOSITORY INSTITUTIONS TO DISCLOSE TO THEIR CUSTOMERS THEIR PRACTICES RELATING TO THE AVAILABILITY OF FUNDS IN CONNECTION WITH CHECK DEPOSITS, TO REQUIRE THE TIMELY PAYMENT OF INTEREST ON DEPOSITS TO INTEREST BEARING ACCOUNTS, AND FOR OTHER PURPOSES

SEPTEMBER 28, 1983

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

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FAIR DEPOSIT AVAILABILITY ACT OF 1983

WEDNESDAY, SEPTEMBER 28, 1983

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING,
AND URBAN AFFAIRS,
SUBCOMMITTEE ON CONSUMER AFFAIRS,
Washington, D.C.

The subcommittee met at 9:30 a.m., in room SD-538, Dirksen Senate Office Building, Senator Paula Hawkins (chairman of the subcommittee) presiding.

Present: Senators Hawkins, Dodd, D'Amato, and Gorton.

OPENING STATEMENT OF SENATOR HAWKINS

Senator HAWKINS. Will the hearing come to order. We have a busy day today in the Senate and may be interrupted. Other members of this subcommittee will be in and out.

I have called this hearing to explore the consequences of the manner in which deposited checks are handled and to review Senate bill 573, the Fair Deposit Availability Act of 1983 which was introduced by my colleague and the distinguished ranking minority subcommittee member, Senator Dodd.

Many banks and savings and loan customers are infuriated by the treatment they receive from depository institutions that handle their deposits. Funds deposited in check form can often be used only after long and frequently unspecified waiting periods, ranging up to 3 weeks or more. And some institutions do not pay interest on deposited checks even after they have received provisional credit for the check.

These practices have serious consequences. Some consumers have lost their credit standing because the banks bounced their checks without giving fair warning that the account is not credited for checks that are deposited even after several weeks.

Recently a general's wife told me the closing check on the house they purchased in Virginia bounced because the bank did not give credit on her husband's salary check when it was deposited in the bank in Virginia.

Some consumers complain that banks even refuse to give immediate credit to cashier's checks, certified checks, and Government checks, even after acceptable identification has been given.

I believe that the refusal to honor immediately social security or annuity checks imposes an unconscionable hardship on retired citizens, who make up a large part of my Florida constituency.

Critics charge that banks and savings institutions who intentionally delay crediting funds do so to profit from the float. Thus, during the time when the checks are honored by the payor banks and the customers have access to these funds, the banks earn interest on their customers' money.

The institutions maintain it is necessary to place holds on checks deposited by customers to lower the risk that checks will return unpaid from the institutions on which they are drawn.

Most institutions have a policy based on their own experience, on how long they wait before honoring deposits. However, these policies do vary widely and many institutions don't make public disclosures of these policies.

I am concerned that the financial institutions and the Federal bank regulators have been slow in responding to consumer concerns over funds-availability policies of depository institutions. Meanwhile, the industry is spending millions to install automatic tellers on practically every street corner. Why can't this new technology be applied to speed the crediting of depositors' checks. Why are they still relying on a paper check return system that dates back to the last century?

Thus, the subcommittee is especially interested in the steps being taken to eliminate the causes of delayed funds. We are particularly interested in what the Federal Reserve Board is doing to speed the confirmation of payment or nonpayment of checks.

[Copy of bill being considered follows:]

II

98TH CONGRESS
1ST SESSION

S. 573

To require depository institutions to disclose to their customers their practices relating to the availability of funds in connection with check deposits, to require the timely payment of interest on deposits to interest bearing accounts, and for other purposes.

IN THE SENATE OF THE UNITED STATES

FEBRUARY 23, 1983

Mr. DODD (for himself and Mr. PROXMIRE) introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

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A BILL

To require depository institutions to disclose to their customers their practices relating to the availability of funds in connection with check deposits, to require the timely payment of interest on deposits to interest bearing accounts, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SHORT TITLE

SECTION 1. This Act may be cited as the "Fair Deposit Availability Act of 1983".

DEFINITIONS

SEC. 2. As used in this Act—

(1) the term "depository institution" means—

(A) any insured bank as defined in section 3 of the Federal Deposit Insurance Act or any bank which is eligible to make application to become an insured bank under section 5 of such Act;

(B) any mutual savings bank as defined in section 3 of the Federal Deposit Insurance Act or any bank which is eligible to make application to become an insured bank under section 5 of such Act;

(C) any savings bank as defined in section 3 of the Federal Deposit Insurance Act or any bank which is eligible to make application to become an insured bank under section 5 of such Act;

(D) any insured credit union as defined in section 101 of the Federal Credit Union Act or any credit union which is eligible to make application to become an insured credit union pursuant to section 201 of such Act;

(E) any member as defined in section 2 of the Federal Home Loan Bank Act; and

(F) any insured institution as defined in section 401 of the National Housing Act or any institution which is eligible to make application to become an insured institution under section 403 of such Act;

(2) the term "deposit account" means an account in a depository institution on which the account holder is permitted to make withdrawals by negotiable or transferable instrument, payment orders of withdrawal, telephone transfers, or other similar items for the purpose of making payments or transfers to third persons or others. Such term includes demand deposits, negotiable order of withdrawal draft accounts, savings deposits subject to automatic transfers, share draft accounts, and all savings deposits and share accounts (other than time deposits); and

(3) the term "Board" means the Board of Governors of the Federal Reserve System.

DISCLOSURE OF FUND AVAILABILITY POLICIES

SEC. 3. (a) Before opening a transaction account, a depository institution shall, in accordance with regulations of the Board, provide a written disclosure to the potential customer of its general policy with respect to when a customer may withdraw funds deposited by check or similar instrument into the customer's deposit account.

(b) A depository institution shall, in accordance with regulations of the Board, either—

(1) furnish its customers preprinted deposit slips, or envelopes for automatic teller machine deposits, bearing a summary statement of its general policy with respect to when a customer may withdraw funds deposited by check or similar instrument into the customer's deposit account; or

(2) in the case of a particular deposit by check or similar instrument into a deposit account for which funds may not be immediately available for withdrawal, provide specific notice of the time the customer may withdraw such funds.

INTEREST ON DEPOSITS

SEC. 4. For the purpose of computing the amount of interest or dividends payable with respect to an interest bearing deposit account, a depository institution may not delay beginning to compute interest on funds deposited by check or similar instrument to such an account beyond the date on which that depository institution receives provisional credit for the check or similar instrument. Nothing in the preceding sentence requires the payment of interest with respect to funds deposited by check or similar instrument which is returned unpaid.

COMPLIANCE WITH ENDORSEMENT STANDARD

SEC. 5. Each depository institution shall place its endorsement on checks and other items described in regulations of the Board in the positions provided for in the endorsement standard (ANSI X 9.3–1981) or in regulations of the Board.

EXPEDITED NOTICE OF NONPAYMENT

SEC. 6. Not later than twenty-four hours after a payor depository institution determines not to pay a check or similar instrument of $250 or more, it shall directly notify the depository institution at which the check was originally deposited of such nonpayment.

DISCLOSURE GUIDELINES

SEC. 7. (a) The Board shall prescribe regulations to carry out this Act. These regulations may contain such definitions, classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for any class of transactions, as the Board determines are necessary.

(b) The Board shall publish model disclosure forms and clauses for common transactions to facilitate compliance with the disclosure requirements of section 3 and to aid customers by utilizing readily understandable language. Nothing in this Act may be construed to require the use of any such model form or clause prescribed by the Board under this section. A depository institution shall be deemed to be in compliance with the provisions of section 3 if it (1) uses any appropriate model form or clause as published by the Board, or (2) uses any such model form or clause and changes it by (A) deleting any information which is not required by this Act, or (B) rearranging the format.

(c) Model disclosure forms and clauses shall be adopted by the Board after notice duly given in the Federal Register and an opportunity for public comment in accordance with section 553 of title 5, United States Code.

ADMINISTRATIVE ENFORCEMENT

SEC. 8. (a) Compliance with the requirements imposed under this Act shall be enforced under—

(1) section 8 of the Federal Deposit Insurance Act in the case of—

(A) national banks, by the Comptroller of the Currency;

(B) member banks of the Federal Reserve System (other than national banks), by the Board; and

(C) banks insured by the Federal Deposit Insurance Corporation (other than members of the Federal Reserve System), by the Board of Directors of the Federal Deposit Insurance Corporation;

(2) section 5(d) of the Home Owner's Loan Act of 1933, section 407 of the National Housing Act, and section 17 of the Federal Home Loan Bank Act, by the Federal Home Loan Bank Board (acting directly or

through the Federal Savings and Loan Insurance Corporation), in the case of any institution subject to any of those provisions; and

(3) the Federal Credit Union Act, by the Administrator of the National Credit Union Administration with respect to any Federal credit union or insured credit union.

(b) For the purpose of the exercise by any agency referred to in subsection (a) of this section of its powers under any Act referred to in that subsection, a violation of any requirement imposed under this Act shall be deemed to be a violation of a requirement imposed under that Act. In addition to its powers under any provision of law specifically referred to in subsection (a) of this section, each of the agencies referred to in that subsection may exercise, for the purpose of enforcing compliance with any requirement imposed under this Act, any other authority conferred on it by law.

(c) Except to the extent that enforcement of the requirements imposed under this Act is specifically committed to some other Government agency under subsection (a) of this section, the appropriate State regulatory authority shall enforce such requirements.

(d) The authority of the Board to issue regulations under this Act does not impair the authority of any other authority designated in this section to make rules respecting its own procedures in enforcing compliance with requirements imposed under this Act.

CIVIL LIABILITY

SEC. 9. (a) Except as otherwise provided in this section, any depository institution which fails to comply with any requirement imposed under section 3 or 4 with respect to any person is liable to such person in an amount equal to the sum of—

(1) any actual damage sustained by such person as a result of the failure;

(2)(A) in the case of an individual action such additional amount as the court may allow, except that the liability under this subparagraph shall not be less than $50 nor greater than $500; or

(B) in the case of a class action, such amount as the court may allow, except that as to each member of the class no minimum recovery shall be applicable, and the total recovery under this subparagraph in any class action or series of class actions arising out of the same failure to comply by the same depository institution shall not be more than the lesser of $500,000 or 1 per centum of the net worth of the depository institution; and

(3) in the case of any successful action to enforce the foregoing liability, the costs of the action, together

with a reasonable attorney's fee as determined by the court.

In determining the amount of award in any class action, the court shall consider, among other relevant factors, the amount of any actual damages awarded, the frequency and persistence of failures of compliance, the resources of the depository institution, the number of persons adversely affected, and the extent to which the failure of compliance was intentional.

(b) A depository institution may not be held liable in any action brought under this section for a violation of section 3 or 4 if the violation was not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid any such error. Examples of a bona fide error include, but are not limited to, clerical, calculation, computer malfunction and programing, and printing errors, except that an error of legal judgment with respect to a person's obligations under this Act is not a bona fide error.

(c) Any action under this section may be brought in any United States district court, or in any other court of competent jurisdiction, within one year from the date of the occurrence of the violation.

(d) No provision of this section imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule, regulation, or interpretation thereof by the Board or in conformity with any interpretation or approval by an official or employee of the Federal Reserve System duly authorized by the Board to issue such interpretations or approvals under such procedures as the Board may prescribe therefor, notwithstanding that after such act or omission has occurred, such rule, regulation, interpretation, or approval is amended, rescinded, or determined by judicial or other authority to be invalid for any reason.

EFFECTIVE DATE

SEC. 10. This Act takes effect upon the expiration of twelve months following its enactment.

We are fortunate to have with us today Vice Chairman Martin, who will discuss the Fed's work in this area. We will also hear from witnesses representing the industry, and others. Together, the witnesses appearing today will shed light on the magnitude of these problems, and I anticipate will suggest ways through Government or private action that we can assure consumers fair treatment on deposited funds.

The first witness today is the Honorable Preston Martin, Vice Chairman of the Federal Reserve Board. He has been before us before and is an old friend. He needs no introduction. We appreciate your appearing here today on this important question, Mr. Martin. I know you are a busy man and due to the time constraints we have today, I will appreciate each witness confining his oral remarks to 5 minutes, and his entire statement will appear in the record as though read.

Welcome, Chairman Martin. You may proceed.

STATEMENT OF PRESTON MARTIN, VICE CHAIRMAN, FEDERAL RESERVE BOARD

Mr. MARTIN. Thank you, Madam Chairman. I appreciate the opportunity to share with you some thoughts on this difficult subject of withholding uncollected funds or delayed availability as it is also styled.

It is certainly a problem at times for some individuals and one that can cause great inconvenience. As you stated in your opening statement, Madam Chairman, there are individual instances of very nearly hardship, and it is of particular concern in a society such as ours which is so characterized by frequent movement of families around the country.

We meet in an area unique for its extensive inward migration, but are aware that while the geographical concentration of this problem is noteworthy, for some depositors in some instances the situation is one that can be a genuine problem.

The bill before us requires disclosure of calculation of interest from the time of provisional credit and proposes standard endorsement and prompt notification procedures. These are all measures which could mitigate the problem and which I know we have all been studying for some years.

Our surveys of consumers and the consumer complaints, received in our enforcement of the statutes, indicate that a majority of consumers do not frequently encounter this problem.

We recognize that two States, my home State of California, and Senator D'Amato's State of New York, have both acted very recently to direct their regulators of commercial banks and thrift institutions—because it isn't just a commercial banking problem—to move in this area, indeed to determine and establish reasonable holding periods for uncollected funds.

I have changed residence enough myself to appreciate and to have encountered this kind of situation. Of course, the holding of uncollected funds as well as the crediting of depositor accounts before the funds are collected are practices both inherent in the structure of a paper transfer system. As the chairperson indicated, as long as the system entails the physical passing of pieces of paper, you will have this range of practices.

In addition to the motivation that you cited, Senator Hawkins, our survey work with financial institutions indicates a second factor, and that is to the financial institution manager, as he or she sees a loss already in the crediting of your and my accounts, when we represent a known depositor needing immediate credit and can draw on a check immediately although there exists a 2- or 3-day collection period.

Of course, there exist holding periods that are too long, and not justified by any operational or credit concerns. But these costs associated with items do come into play. It is a long, tenuous process in which a check goes from the bank of deposit to a correspondent bank, to a Federal Reserve bank, to a correspondent bank, to the payor bank and back. The chain of collection and return can be a slow and an expensive one.

We have, as I indicated on the bottom of page 2, made a number of operational changes in check collection; changes which will, we believe, accelerate their collection. But, in this regard we are primarily talking only about the 50 million checks that the Fed clears each day, and with which we have direct involvement. We have been assertive in shortening the collection time and this had generated some controversy within the industry. As we have moved our presentment time to a later time to accommodate this clearing process, we have encountered resistance from segments of the industry. However, we remain firm in our belief that these improvements will speed up the collection process.

We have also revised our transportation network, the interdistrict transportation system, in ways to speed up the collection process.

When you speed up the collection process you tend to shorten the time financial institutions need to withhold funds availability from their customers. But I would be less than candid if I didn't say this effort to speed up the total collection process may not specifically impact industry practices regarding holds on uncollected funds.

NEW PILOT PROGRAM BEING TESTED

On the subject of improving the check collection process, I wanted to discuss the preliminary results of a pilot program that is being conducted through the Dallas Federal Reserve Bank. We are taking returned items that initially were cleared through the Federal Reserve System and experimenting with such alternatives as a direct notification process that could ultimately result in the bypassing of the collection stream intermediaries and going to that first depositing bank to notify them of a returned item. That notification process is not one that is technologically staggering. However, we use the telephone most of the time, and the wire transfer system, and that can be expensive, involving additional labor and other costs. But we are going to continue to push in that pilot project to see if there aren't ways to implement these improved procedures.

Obviously the imposition of blanket hold policies for certain categories of checks seems to me to be an obsolesent way to handle the risks inherent in return item processing. We all know that the commercial banks and thrift institutions are going through elaborate training programs to teach their tellers how to explain the new deposit instruments, and to some extent, new procedures involved on the lending side—the adjustable rate mortgages, indexed rates, and so forth. In that regard, it seems that a better job could be done in training tellers to provide the kind of information necessary to adequately disclose funds availability policies or possibly to include a disclosure on the receipts that come out of an ATM, as the chairperson mentioned. Even in the area of mailed deposits it seems to me that the process could be improved to allow for better notification when there will be a hold for uncollected funds.

I think also tellers ought to do a better job in notifying a customer the date the funds will be available. "They will be available on the 27th." Say that "it is our policy to put a hold on these out-of-State uncollected funds." But, you can't imply it isn't a good check, just that the money should be available on the 27th.

Of all the hold disclosure processes, specific disclosure, not just general disclosure, would probably be the most effective, because we all know how much paperwork we get from our financial institution, and most of us don't read all of it. You need somebody to tell you that the funds will be available on a specific date. Thus, specific disclosure in addition to the general disclosure on printed materials coming through the mail or an ATM would be desirable.

I would say in conclusion that we are aware that this is an area of customer service that should be addressed by each financial institution. We will continue to collect information and share with you what we find. We are considering the addition of another series to our examining process, so that we can collect concerning the extent to which disclosure and the model forms and the other recommendations from the various trade groups to their membership have been adopted.

Since the problems stemming from delayed availability are, by and large, specific to an individual and since the incidence of this difficulty—and a difficulty it is—is not widespread, we would not support statutory enactment or regulatory intervention at this time.

I realize if the problem is not recognized by the industry, that there may have to be such action in the future. But I am encouraged that the first moves are being made by the industry, and I think it can be solved at that level.

That is our identification of the problem; we have a very specific question here, and to apply a general blanket statute or blanket set of regulations will be, I think, inappropriate, particularly with regard to the smaller institutions—small banks and savings and loans—who are struggling to cope with the regulations already imposed on them.

I think the community banking and community thrift institutions are very important to this country and their survival is somewhat under a cloud as they begin to pay market rates on significant portions of their liabilities. That they should pay market rates is in the interest of the public and to benefit the savers, and that is appropriate. But this is a new experience for many of them and they are struggling with it. Thus I think particularly for the small institutions, let's not put too many regulations on them until we are convinced the industry can't cure the problem by itself.

Senator D'AMATO. Madam Chairman, if I might——

Senator HAWKINS. Senator D'Amato.

ADDITIONAL REGULATION MAY BE NEEDED

Senator D'AMATO. You know when we say "let us not impose another regulation on the banks," I have some concern if they are engaged in a practice which benefits the banks by giving them the ability to utilize the float, being able to use these moneys as opposed to putting these funds where they should be—that being the customer's account earning interest for the consumer or depositor.

You would not be suggesting that to the extent that this practice is a consumer abuse which banks have perpetrated for many years, that it should be continued. You are not suggesting that, are you?

Mr. MARTIN. I think a commercial bank, savings and loan, or credit union, should pay interest to its depositor on that balance from the date of deposit, not from the date of provisional credit. However, I think that the bank teller should say to the depositor, "This is a fairly large amount of money. Do you want to put it in this account *x* that pays *y* interest while you wait for these funds to be collected?"

Senator D'AMATO. Are you ready to suggest a rule or regulation for that?

Mr. MARTIN. No, sir.

Senator D'AMATO. Then we have to deal with this problem. I don't want to take too much time, but I just couldn't let that go. I don't think anybody on this panel or involved with this proposed legislation intends to bring about undue restrictions on the community banks.

I have been a great supporter of the community bank and the local thrifts. I have worked and supported legislation that would make it possible for the thrift industry to survive. I pushed the administration and OMB and Treasury when they made believe there was no problem with the thrift industry; they hid their heads in the sand and exacerbated it by not dealing with the problem sooner. You know what I am talking about. That is why I wanted the record to clearly indicate that no one is attempting to unduly regulate the banks. I commend Senator Hawkins for holding this hearing, and I commend Senator Dodd and Senator Proxmire for putting forth S. 573.

My own inclination is to say that this bill may not go far enough. But we can talk to that. We may need stronger provisions in it such as contained in legislation that has been passed in the State of New York, which I think is quite responsible. And the banking community has not really opposed that New York law. In any case, a policy should be clearly established and people should know how long it takes to clear their checks.

Then there is the issue of whether we are going to allow the industry to use antiquated manual processing procedures so that the bad checks take an inordinate period of time when they could be done by automation. Certainly there should at least be some rules and regs prescribing the return by another system.

So I think these hearings are necessary, Madam Chairman. I request that my entire statement be printed in the record.

OPENING STATEMENT BY SENATOR D'AMATO

Senator D'AMATO. I would first like to commend Senator Hawkins for holding this hearing on S. 573, the Fair Deposit Availability Act of 1983, which has been introduced by Senators Dodd and Proxmire.

In essence, the issue before us is one which requires a reasoned balancing of the interests of consumers, who often discover that legitimate checks deposited in their accounts are lost in a "twilight zone," somewhere between the depository bank and the chain of banks involved in the payment process, and the concerns of financial institutions, which have a legitimate interest in protecting themselves against fraud losses.

The question really is whether or not the risk of loss avoided by a bank in instituting a specific delayed funds availability policy is of a sufficient magnitude to justify the numerous burdens borne by the consumer as a result of that policy; namely, the inability to draw on funds deposited, widespread confusion as to bank policies regarding funds' availability and the possibility of inadvertently bouncing checks and permanently scarring the consumer's credit rating.

The New York State Banking Department, pursuant to a recent State statute, has proposed regulations which would require all banks operating in New York to abide by specific delayed funds availability policies. Maximum allowable clearing time periods would range from 1 or 2 business days for checks drawn on local banks to 6 for out-of-State banks. Senator Dodd's bill, S. 573, would require disclosure by banks of their delayed funds availability policies and the timely payment of interest on deposited checks, a modest proposal in comparison to the New York State regulation.

Surprisingly, bankers doing business in New York have expressed little opposition to the proposed State regulation, with many banks reporting that only minor changes need be made in their policies to comply. Thus, I would hope the witnesses here today will attempt to balance for us the perceived burdens the S. 578 disclosure bill would impose on banks in comparison to the bill's consumer benefits. Does the bill go far enough, or should we be looking toward mandatory clearing period requirements as New York State has done?

Senator HAWKINS. Thank you, Senator D'Amato.

Senator Dodd.

OPENING STATEMENT OF SENATOR DODD

Senator DODD. Thank you, Madam Chairman. I am glad to hear your statement, Senator D'Amato. I hope we don't have to go further. I appreciate your efforts on this issue.

Almost 19 months ago, Senator Chafee and I conducted a hearing in this room on the general problems associated with bank practices of placing lengthy holds on deposited checks. We found the practice was widespread, thus confirming the public and private surveys on the subject back in the 1970's. We also found that it often had serious consequences for consumers and small businesses.

Talking about small banks, small businesses suffer also from some of these practices as a result of nonavailability of their deposits.

At any rate, in addition to that, we found in some situations that actually the consumers and small businesses were assessed penalties by both the bank and the merchant for bounced checks as a result of lack of availability of funds.

In March 1982, Senator Chafee and I expressed the hope that the industry and the Fed would start studying the problem, we have had a lot of studies, and take the necessary steps to eliminate it. And both the Fed, as you recall, and the American Bankers Association, assured us action would be taken. The Fed spoke about doing a study to speed up the check return system, and the ABA talked about moving to encourage bank disclosures and other practices. That was in March 1982.

I waited 1½ years and nothing happened. When I had seen neither hide nor hair of the new Fed study which had been promised, which I was told would not take very long, nor any action on the part of the ABA, that is when I introduced S. 573. Senators Proxmire and Cranston cosponsored this bill.

This bill is designed to do what the Fed and the ABA reluctantly promised to do, and that is put an end to unfair practices. First, the bill would require the banks to disclose their hold practices to customers, and thus customers would have this information at the time they are actually making deposits. The bill doesn't stop at disclosure, because disclosure will not solve the problem. As long as the system for returning bad checks remains antiquated, the banks will have to maintain long hold periods to protect themselves from bad checks. So aside from the issue of disclosure, to permit banks to continue to utilize long hold periods would be, I think, grossly unfair. When consumers have acted responsibly, bouncing less than 1 percent of all checks that are deposited, then I think the banks have a reciprocal obligation to provide a faster return system to those customers.

To their credit, the banking industry has pointed out the way to the solution by supporting the development of a standard enforcement system by the American National Standards Institute, requiring that different banks in the collection system endorse the back of the check in specific areas. That will eliminate the present problem of identifying the bank that first cashed the check, which flows from the fact that banks presently often stamp one on top of another.

The only problem is the standard is not in place, even though the ABA supported it. S. 573 would simply require the industry to use the standard it developed.

So the first two parts of the bill have enjoyed support—the ABA sent out a letter saying you should have disclosure, and the ABA supported the development of the ANSI standard.

That would make the last portion of the bill workable—although it has some potential problems, and I am willing to listen to them—namely, the bank with a bad check of $250 or more notify the bank that cashed the check within 24 hours if the check is no good. Others have talked about $2,500, and other ways of getting the information back.

I am willing to listen to all sorts of ideas about how you can do that. With a fast return system in place, and disclosure to customers, I would expect competition to work and reduce hold periods to no more than 3 or 4 days in most cases.

There is a likelihood this problem can be solved without legislation. I think the chances are slim. I would like to believe it can be solved without it. I would point out, though, that we are looking at a situation where the States are beginning to take action, and it is a lot tougher than anything I am suggesting here. The worst, then, that I presume could happen today is to have 50 sets of legislation dealing with hold periods.

So while we may hope for voluntary action, the record over the last couple of years doesn't promise it.

As I mentioned, it is 1½ years since the last hearing, the California and New York situations, the ARA letters have gone out. At any rate, I don't think we are going to see much happen.

I am deeply grateful to you, Madam Chairman, and I am anxious for some ideas and suggestions and I would add, as Senator D'Amato has said, no one is interested in penalizing the small banks. That has a tendency sometimes to send people scurrying because no one wants to hurt these small entities. We are all sensitive to that. But the problem is one that in 1983 ought to be easily solved. We are in a computer age and the antiquated methods of moving checks around in light of the fact we can virtually send billions of dollars across the globe with the speed of light, you can't convince me we can't come up with a system that will be equitable to the consumers and let them know what their financial situation is regarding deposits.

I thank you.

IMMEDIATE ACCESS TO GOVERNMENT CHECKS

Senator HAWKINS. Thank you, Senator Dodd. Mr. Martin, we have received a lot of complaints that banks refuse to treat Government checks as cash, and give depositors immediate access to those funds. That hurts retirees in my State and everyone on social security who needs access to his or her funds.

What can be done to correct that unconscionable situation?

Mr. MARTIN. Well, certainly it is a most unfortunate situation when a retiree or other recepient of a Treasury check finds that his or her financial institution won't honor it immediately. Of course, the vast majority of them are honored immediately. What we have found is it is typically a new depositor, unknown to that teller in that bank or one who doesn't have an account there, on to which this hold is placed.

Senator HAWKINS. Why on a Government check?

Mr. MARTIN. I am told that the number of forgeries in this area is very, very large. That is the rationale for the practice that we have heard.

Senator HAWKINS. You said in your earlier statement that it may be a new customer who has opened an account. You are saying they have opened the account and the first check is held up, but the second check, the second social security check, is that cleared at once?

Mr. MARTIN. It may be a circumstance such as that. Of course, the response of a depositor should be to ask to talk to a bank officer and not accept a decision from a less experienced person in the bank in this matter.

Senator HAWKINS. You are talking about a sophisticated type depositor. I am talking about a senior citizen, who has a modest check. Senior citizens move to Florida in record numbers. I can't think of a reason why, once you have opened an account with a social security check the funds wouldn't be cleared at once. I know mine wouldn't be cleared at once. How about yours?

Mr. MARTIN. I am sure mine wouldn't be.

Senator HAWKINS. I think that is something we have to address at once. That is something I am out of patience with. Like Senator Dodd, I don't like regulation; the Banking Committee wants to deregulate everything. But we have to consider some legitimate concerns, prioritize the concerns of consumers in this tremendous amount of chaos we are seeing in deregulation. Maybe we will have another bank that will clear at once, and they will get all of the money in town.

In my opinion the problem that has to be addressed is that of so many people on fixed incomes who get their total amount of money from the Government.

Tell me what is the purpose of a cashier's check, if it is not to be treated as cash?

Mr. MARTIN. The purpose of it is so it may be treated as cash. It is to put the force of the credit of another institution behind that check.

Senator HAWKINS. Why shouldn't the banks be required to give immediate access to such funds if they have proper identification?

Mr. MARTIN. They could certainly be required to do so. There are again, however, a number of cases of fraud and forgery in this area and if the bank is required to give immediate availability on these items, then the losses that will occur due to forgery and other circumstances will most likely be passed on in increased costs to all of the customers of the bank.

Senator HAWKINS. Do you have any evidence that banks in some areas are setting delayed funds policy by getting together? Do they meet together and in this community say "This is our practice?"

Mr. MARTIN. No, nothing in the review that I did prior to this hearing shows anything of that sort.

Indeed, we have a problem here because of an opposite attitude of bankers toward this problem. To them it isn't a problem, to them it isn't a high enough priority item to get their attention. It isn't that they act together and set a 14-day policy. They are just using an old Federal Reserve clearing schedule that is 20 years old—the way checks used to be cleared in 1962 or something—and they have never bothered to update and modernize it. The issue just doesn't get their attention.

Senator HAWKINS. But it is not that they haven't been warned. As Senator Dodd said, in 1981, 1982, and 1983, and I wrote a letter asking how the Federal Reserve was getting along in Texas with the pilot study.

That is not what we want here; we want action.

It seems to me we could have action if we mandate that the banks put an insert in their monthly statements on the bank's policy. It seems to me we may have to mandate that disclosure be made to the consumer.

Why could not the banks be assigned machine-readable routing and transit numbers for the return of checks?

Mr. MARTIN. That is certainly a possibility. There are significant costs attached to a solution such as that, but we hope that from the results of the Dallas project, we will be able to develop a technique or procedure—perhaps a paper that could be placed on the returned check to speed its routing—to make return items more machine-readable.

We should, however, call your attention to the fact that five States and the District of Columbia do not permit the direct——

Senator HAWKINS. Five States?

Mr. MARTIN. Five States. It used to be six until California acted a few days ago. Five States and the District of Columbia do not permit the direct return of items. We call that to your attention as one of the obstacles to progress in implementing operational solutions to the return item matter.

We think within the scope of the Dallas experiment we can convince the banking and thrift institutions in that district to accept and support direct returns. If we are successful in that, and can get beyond the constraints of our limited presence in check clearing—we handle only 30 or 35 percent of the checks cleared—we will begin to develop a returned item experience that can be useful to this committee.

Senator HAWKINS. I think it is obvious that one of the problems is the banks have an incentive to expedite the forward trip to gain the float, but there is no incentive for them to have a rapid return. Because the clearing mechanism is national in scope, as you pointed out, should there not be a national policy on delayed funds availability?

Mr. MARTIN. I think there should be a national policy. The question is the implementation of it, which is the subject of this hearing.

Senator HAWKINS. It has been suggested that depositors could use wire transfers for big items like the sale of a house or the transfer of an account when moving.

Do the banks routinely advise their customers about these services?

EXPENSE A PROBLEM FOR SMALL BANKS

Mr. MARTIN. I would like to think that they do routinely advise their customers of wire transfer. Wire transfer, of course, can be expensive.

Senator HAWKINS. How expensive?

Mr. MARTIN. The expense, of course, includes labor time, telephone time, and the the costs associated with computer and communications software and hardware run. Our charges to the institutions range from $1 to $1.80 per transfer and a lot of those transfers are still done by telephone.

Senator **Hawkins**. What is the gross take of the banks in the float on delayed funds, do you know?

Mr. **Martin**. No, I do not.

Senator **Hawkins**. Would you provide that for the record?

Mr. **Martin**. It is very difficult to measure as our response to Senator Dodd's previous inquiry on this indicates. One has to make some assumptions that are pretty heroic. For instance, you have to make an assumption in the case of a check deposit about how much of that deposit would have been drawn upon, and how much of it would have been left in the account regardless of any uncollected funds policy. That involves some pretty arbitrary numbers.

Senator **Hawkins**. Is part of the problem that a corporation may use remote payor banks to gain flow?

Mr. **Martin**. I don't think that is a problem we are addressing today. That certainly is a——

Senator **Hawkins**. Is that in the back of your mind?

Mr. **Martin**. That certainly is an arrangement that I think is unfortunate. Of course we have introduced a number of policies to reduce float, and have reduced it very considerably. But we still struggle with that.

Senator **Hawkins**. Thank you. Senator D'Amato.

Senator **D'Amato**. Madam Chairman, you have covered many of the areas of my concern.

Mr. Martin, I notice that Professor Wechsler, in his testimony, focuses on reducing the time in returning bad checks. He seems to think that is the pivotal area of concern, and if a reduction in return time can be made, why then there is no reason why a stricter policy cannot be implemented regarding availability. In section 5 of the proposed legislation, S. 573, there is a requirement that the depository institutions follow the American National Standards Institute 1981 recommended standards for check endorsements.

Indeed the professor's testimony—he will be testifying on the next panel—seems to say with a shortened return period unreasonable risk of loss for the depository banks can be eliminated, thus shortening the holding period on checks. Do you agree with that?

Mr. **Martin**. I think the American National Standards Institute approach is a good one and we have endorsed it informally. Our caveat again, would be with regard to the costs to the small institutions. They are not set up to easily accept these changes and they are not automated. They are doing things manually, and that would be my only caveat.

Senator **D'Amato**. What burden would utilizing this system place on them?

Mr. **Martin**. They would have to make changes in operations that could entail significant investment and costs.

Senator **D'Amato**. They would have to use computers and things like that?

Mr. **Martin**. It would certainly push them toward a greater reliance on computer technology.

Senator **D'Amato**. If they are not using computers now, they are not going to be around long in this world anyway. I mean let's look at this now. I am a small town boy, you say New York, but I lived in a village of 5,300 people. You do not know what I had to do to fight to get another bank to go in there.

So I understand, and I want to see that we do have the small personalized institutions; but desperately as we want them, we see them disappearing. You don't even speak to a teller any more, you walk in on Saturdays and press those buttons. My mama gets upset and runs away from them anyway. I understand that. Where do you live now?

Mr. **Martin**. I live in the District of Columbia.

Senator D'**Amato**. You live in a big town here. If you do not take this problem seriously, you are going to get a law that will make S. 573 look like a piker. I cannot really believe in this day and age consumers have to be penalized by bouncing otherwise good checks.

So we have not done nearly enough. You do not mean to tell me it is a big deal to take a survey with respect to return policies—I don't mean one of these 6- or 8- or 10-month studies. You have been studying these problems, but there has been testimony that this has been an issue that has been around for awhile now. Maybe you do not take us seriously.

Mr. **Martin**. We certainly take it seriously.

Senator D'**Amato**. What is this cost factor in implementing a wire service program for bad checks, 1 percent of the checks that do bounce? How costly is it?

Mr. **Martin**. I would say that I agree with the direction of your points. In terms of computers in small institutions, several Federal Reserve Banks are actively introducing computer technology to the smaller institutions within their district.

Senator D'**Amato**. Let me simply suggest this: I believe it is really incumbent on our regulators to aid and assist in the process of dealing with this problem. I think there are more innovative ways to approach the problem. You have larger institutions who, with a gentle nudging, could certainly see their way to make available to their little brethren these various kinds of services such as computers and access to other communication networks to speed up the clearing process.

Then would not that type of approach make the universal application of the American Standards Institute's 1981 specifications for check endorsement possible, and cut down the return time? How much would you cut down the time on the bad check returns with those standards? Do you have any idea?

Mr. **Martin**. We don't have a precise idea. If you talk about 12 to 13 working days for a return item to go through all of the intermediate banks, and you could notify the next day by wire——

Senator D'**Amato**. Would you say about 3 days it would cut it down? Would it reduce the time to 3 days?

Mr. **Martin**. I would think it would reduce it to somewhere in that area.

Senator D'**Amato**. We are talking about 10 working days or 2 weeks. That is going to stop a lot of checks from bouncing unnecessarily, and a lot of credit ratings from being impaired. And, if it is 1 percent of all checks that are bad, certainly it is a significant volume. It seems as though it is time to change the institutional mentality to effect these changes.

CONSUMERS MUST ACCEPT SOME CHANGES

Mr. **Martin**. It is also the attitude of consumers toward checks. Where institutions are sending a statement out instead of sending all of the checks back, which seems to make a lot of sense, the consumers don't accept that. There is a resistance to not getting those little pieces of paper back.

Senator **Hawkins**. I love those little pieces of paper. If my bank ever stops sending me my canceled checks, they are in deep trouble. What I do not need is another 17 pages of dates, numbers, and the amount.

Senator **Dodd**. I like them, too.

Senator **D'Amato**. It really comes down to the banks playing a float. I have enough trouble with them, they are mad at me now because I do not want to give them new powers to do almost everything. Let them get the checks back before they start doing everything else. That is another day, another year. But you know, you have to insist on this, don't you think so? With this Dallas experiment, you ought to be a leader, you ought to be out there pushing this. You are not just regulators. What can you do to advance this experiment?

Mr. **Martin**. We can push the Dallas experiment in terms of its calendar to begin to get a wider and wider scope on the returned checks project there. We can move it out to different kinds of checks within that district, and that is a big, high volume transfer district.

Senator **D'Amato**. How about my little people up in New York? How about my mama? What about her, and all of the other people up there?

Mr. **Martin**. We have great respect for the autonomy——

Senator **Dodd**. You better be careful about what you say about mothers and fathers in New York.

Senator **Hawkins**. They are pushing the automatic tellers, everybody has a different name for this gadget. We have to have police by every one of them in Florida, because that is the best place to get ripped off. If Sam, the teller, which is what we call automatic tellers in Florida, takes the money and the depositor thinks she is going to get immediate credit, but she doesn't get immediate credit. She still has to wait the 10 days.

Senator **D'Amato**. Let me just suggest one thing, and, Madam Chairman, I beg your indulgence, I have to leave for another hearing.

First of all, let me commend Senator Dodd, who has pursued this problem. But I think we may need more than an experiment.

You know, if Senators Hawkins and Dodd get together and push a bill, you are in big trouble. That bill is going to pass. I want to tell you something, my mama likes that bill. She is mad as hell at what she perceives is taking place at the consumer's expense. There is no good reason why there is not put into effect a system that would define a clear policy with respect to the return of these instruments within a period of time that is reasonable, and to those who cannot do it, then maybe they should not be in the business.

No one is saying 48 hours. Do they need 5 working days perhaps? But you can not have a situation where everybody is 13, 14, 15 working days, simply because we say they can't afford it. I don't think anybody can accuse this Senator of being unduly restrictive when it comes to rules and regulations and imposing standards on industry and business.

But, I think we better focus in on this on a regulatory level, because I see this legislation moving.

Senator DODD. I am going to be the voice of moderation.

Senator D'AMATO. Do you believe that? Senator Dodd has become the conservative.

Senator DODD. I didn't pay him to be here this morning either.

Senator D'AMATO. I suggest that Senator Dodd's approach is reasonable, but I think it leaves something to be desired.

Thank you, Madam Chairman. Thank you, Mr. Martin.

Senator HAWKINS. Senator Dodd.

Senator DODD. Just a couple of questions. You made the point, Mr. Martin, that this is not a significant problem. I don't think anyone has suggested that this is a cosmic issue. There are some 50 million checking and saving accounts. If that figure is correct, and I believe it is, then 11 percent—the number of people who have problems, according to the Fed—would be roughly 5 million. If 11 percent of the people have problems, at least those numbers seem right, then it is not huge, but it is still sizable.

Mr. MARTIN. Yes, it is.

MANY STUDIES MADE BUT NO ACTION TAKEN

Senator DODD. And the frequency with which it happens is obviously an important element. But it can happen only once or twice to someone and it can affect them in a variety of ways.

What we are suggesting is trying to clean up a thorny problem, not a huge problem, not a problem that will crystalize the attention of every Member of Congress for the next month, it is not going to be a headline story, it is just a problem that should be addressed. It goes back 6 or 7 years.

Senator Proxmire wrote the Fed in 1977. In 1978 there was a Fed survey. In 1979 the Fed and ABA put together a study group which included no consumers, by the way, to look at the deferred funds availability issue.

Mr. MARTIN. Excuse me, Senator, could I answer that? We did have a review that same year by our Consumer Advisory Council, which is roughly one-half consumer representatives and one-half financial institution people.

Senator DODD. That was in 1979?

Mr. MARTIN. Yes, sir, 1979.

Senator DODD. The point is they recommended in 1979 that there be more flexibility in this whole area, which was a modest proposal. But there was no action in the post-1979 period.

Ten days before the hearing last year the Fed and the ABA said we have got to do another study. Mr. Allison in that hearing said "It won't take very long" to get that study done. A year and a half later we are sitting here, and with all due respect, no mention was made of that study that was supposed to have been done a year and a half ago. We see no reference to that in your testimony.

Then in 1981, ABA and the American National Standards Institute made recommendations again on how to improve the check clearing process. Again nothing was done about that at all.

Then on August 5, a month or so before this hearing, the ABA sent out a letter calling on its members to disclose their hold policies voluntarily.

So we have kind of been through this thing; it is not as though this is a new idea. I would be the first one to say if we were bringing this up for the first time, to say let's get the ABA and the industry to move without this action, and wait a year or so and see. But we have already done that. So I would hope we might do something. I think it would be in the banking industry's best interests. I happen to think, frankly, the California and New York situations are too restrictive, I think there should be flexibility in the hold period. We have a variety of customers and different fact situations that arise and to have a rigid standard that has to apply to every customer that comes to the bank, regardless of their history or their business, is not realistic.

So I am not suggesting it be rigid, but I will tell you because of our efforts to get something done here, you will see a proliferation of State actions in this area. I don't think that is in the Federal interest, the banks' interest or the consumers' interest. So I would hope we might do something here.

If the banks are going to do it anyway, if the ABA recommends they come up with a disclosure on the hold period, we will assist in this effort by this legislation.

We are also going to require what the ABA suggested, that there be some good identification on the back of those checks. Again we are only doing what has been recommended by the private sector.

On the notification, we are all anxious to hear good ideas of how that can be done. It may be expensive to use the wire, maybe you can do it with a telex or telegram or something that would cut down the cost, I understand, significantly in terms of notification on the return trip of that check.

The Dallas experience you have mentioned. I just wondered is there any—I realize it is early—is there anything in that study at all that would confirm what we recommend in the legislation as the way to proceed?

Mr. **Martin**. Certainly the early results in that Federal district have been strongly in favor of direct notification, and I made a note of the telex-telegram suggestion. I will get in touch with the president of the Dallas bank today and raise this issue with him. I don't know why they don't use that method. But, yes, direct notification is useful and effective.

Senator **Dodd**. And it can be done. We are not talking about technology that doesn't exist, isn't that correct?

Mr. **Martin**. Yes, sir.

Senator **Dodd**. Even small banks have that capacity, don't they?

Mr. **Martin**. Small banks can be reached by the telephone.

Senator **Dodd**. Yes. We are not talking about 19th century stuff here, are we?

Mr. **Martin**. No, sir.

Senator **Dodd**. Just one last point. Professor Wechsler in some very thoughtful testimony which we will hear shortly makes some recommendations. Have you had a chance to look at his testimony?

Mr. **Martin**. I haven't had that opportunity, no.

Senator **Dodd**. He just suggests the Fed issue some regulations which in effect, as I read them, pretty much do what our legislation suggests, requiring use of an endorsement standard, requiring use of direct notification, direct return of checks. He says $100 would be the cutoff, we used $250, and require release of deposited funds on a certain timetable.

Would it be possible through simple regulation to do what he suggests here?

Mr. **Martin**. We would probably have to make a finding that this was an unfair and deceptive practice, a finding we have not made and don't feel we have a basis for. The problem is an occurrence, a time-to-time occurrence. It is not a widespread phenomenon.

Senator **Dodd**. Yes. So you would suggest that if we go one way or the other, the legislation is the better way to go? I realize where you stand on the legislation. But that would seem to be wiser?

Mr. **Martin**. I guess what we are saying is that the problem is more the result of obsolescent practices, old approaches. It is not an intent to defraud anybody.

Senator **D'Amato**. If I may say it, with all due deference, I can't buy that. You cannot really come here and say we are tolerating an obsolescent practice for no good reason, especially if they can be addressed by a number of suggestions that have been put forth by both Professor Wechsler and yourself. I mean don't say "well the reason this isn't some kind of abuse is simply because it is obsolescence." When do we say, "We no longer will tolerate this 'planned obsolescence.' You have got to make a change?" Why shouldn't you put out a regulation that says within the next 6 months or some period of time these are the procedures by which you return bad checks, in terms of wire notification for instance.

I would suggest you ought to get counsel to reexamine the possibility of promulgating rules and regulations to address this problem, instead of just saying it is a problem of obsolescence.

I agree it is a problem of obsolescence. But I think you have the ability to change that.

Senator **Dodd**. Thank you. I think Senator D'Amato's questions are good. Certainly it is a quicker way of doing this. But I have to be suspicious. I don't have a conspiratorial view of history, but obsolescence is not a reason for this continuing practice. I happen to believe clearly there are some other issues involved. If it were strictly a question of obsolescence, given the availability of technology, I suspect that the banking community would have long since done away with the practice if it were really obsolescence. I think we are talking about more than just obsolescence here.

Senator **D'Amato**. The float.

Senator **Dodd**. So I would urge you to consider that as well. Thank you for being here today.

Mr. **Martin**. Thank you very much.

Senator **Hawkins**. Senator Gorton?

Senator **Gorton**. No questions, Madam Chairman.

Senator **Hawkins**. Thank you, Mr. Martin. We appreciate your helping us solve this problem here today.

Mr. **Martin**. Thank you for your time.

Senator **Hawkins**. We may have some other questions for you. The record will remain open for the members of the subcommittee that may want to ask you other questions.

[The complete statement of Mr. Martin follows:]

STATEMENT BY PRESTON MARTIN, VICE CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

I am pleased to appear before this subcommittee to present the views of the Federal Reserve Board on S. 573 -- the "Fair Deposit Availability Act of 1983." This bill addresses the practice of depository institutions prohibiting a depositor from withdrawing funds represented by a newly deposited check for some period. This is often referred to as "delayed availability." The bill requires disclosure of an institution's policy regarding delayed availability, calculation of interest from the time the institution receives provisional credit for a check deposited into an interest-bearing account, use of standard endorsement procedures, and prompt notification of a decision not to pay because of insufficient funds or other reasons.

Although the Board's surveys of consumers and the recording of consumer complaints do not indicate that a majority of consumers have frequent problems with delayed availability, our information does not indicate that the problems are in any way trivial. The problems caused by delayed availability range from minor inconvenience, to service charges for checks written before deposits are deemed "good," to hardships caused by the depositor's inability to use needed funds. Two states, New York and California, have already passed legislation on the subject. These laws, which go further than S.573, not only require the disclosure of "hold" policies, but also direct state officials to establish, by regulation, what constitutes reasonable delays under different circumstances.

I have changed residence enough to understand the concerns that have been expressed about certain delayed funds availability policies, and am sympathetic to the problems that customers, particularly new depositors, can experience. As I see it there are two situations giving rise to problems -- those instances in which the practice is not disclosed in advance, and those times when an institution's policy can be construed as so inflexible or unreasonable that it imposes an undue hardship on its customers.

In considering the question of delayed funds availability, it is important, however, to recognize that the practice in some form is inherent within the structure of our check payment system. Since the passage of the Monetary Control Act of 1980 there has been considerable impetus within the financial industry to arrive at greater efficiency in the collection of checks. Notwithstanding this progress, it still takes up to two days for an institution to receive provisional credit for a check. In addition to this delay, it may take several days longer for a check that is not honored by the paying institution to be returned. Without going into the details of that system, which are outlined in Attachment A, these delays give rise to the argument that institutions are exposed to risk of loss in releasing funds before allowing for the time for an unpaid check to be returned. As long as the payments system involves the movement of paper checks from one point to another, there will be delays in the check collection process that may justify an institution delaying availability of funds to some depositors on some items to protect against such risks.

In conjunction with our responsibilities under the Monetary Control Act, the Federal Reserve has made a number of operational changes in our check collection operations, several of which offer the promise of accelerating collection. These include improving our transportation system to speed the physical movement of checks and establishing later hours during which institutions can deposit checks for collection and for us to present them for payment. We have also proposed a program to accelerate collection of checks drawn on high dollar volume institutions located in cities remote from a Federal Reserve check processing office. This proposal would prevent the delays in collection arising from shifts in check clearing volume away from institutions located in cities with a Federal Reserve check processing office. Although it is our belief that these new procedures can greatly benefit the efficiency of checks as a payments mechanism, it is too early to tell the extent to which these changes will positively affect industry practices in regard to delayed funds availability.

Though I believe there is some justification for some of the practice of delayed availability, I also believe that there is a need for financial industry action, and for additional operational improvements which could alleviate much of the problem. Specifically, I am encouraged by a recent call by industry groups, such as the American Bankers Association, for voluntary action on the delayed funds issue by their members. The president of the ABA has written all member banks urging a written policy concerning delayed funds availability, and disclosure of that policy to customers. In addition, the ABA has provided institutions with a model policy and disclosure form.

As an example of possible additional operational improvements now being pursued, we are pleased with the early results of a pilot program of the Dallas Federal Reserve Bank with regard to processing returned checks. This pilot program will help to determine the feasibility of establishing a nationwide service for the direct return of unpaid checks to the institution of first deposit, thereby shortening the chain of institutions in the return process and accelerating funds availability. A nationwide system for prompt return of checks would provide a framework for institutions to provide faster funds availability to their customers.

Disclosure

There are two reasons for promoting greater disclosure of funds availability policies. The first is simply the fairness of alerting the public to practices which may affect them adversely. The second is the impact that disclosure can have on the practice itself. As institution management formalizes its policies and prepares disclosures, it is likely to reexamine the necessity and reasonableness of existing practices.

Of course, the reasonableness of a particular institution's policy with respect to delaying availability is difficult to determine. Many factors go into an institution's or a bank employee's decision to delay availability and the length of the delay. Some institutions with short or no delays compensate for their risk of loss through increased service charges. Some institutions may establish blanket hold policies for certain categories of checks as the most operationally efficient hold policy. Other institutions may place holds on an individual basis, a more costly, but also generally a more equitable procedure. Whether or not an institution's policy can be considered reasonable is best left up to its customers and the discipline of the marketplace. But this requires that customers be informed about their institution's policy. Without disclosure by management, customers will not be able to judge the reasonableness of policies, and competition in the marketplace will not be able to impact the decisions of individual institutions.

In contemplation of the recent action by the ABA, and in order to provide a benchmark for measuring the effectiveness of this effort, the Board conducted a survey of consumers in March of this year to determine the level of consumer awareness of their institution's policy and the incidence of consumer problems with delayed availability. Attachment B summarizes the results. We plan to conduct a similar survey next year to measure any increase in awareness as a result of the ABA's suggestion. In addition, we are considering conducting a survey of financial institutions sometime next year to determine the number of institutions that are, in fact, disclosing their policies. The information from these surveys will be valuable in determining whether the banking industry has responded to the challenge of voluntarily dealing with the issue and whether disclosures, if made, result in an improvement in consumer awareness.

Of course, the problem of delayed funds is not limited to commercial banks. It involves all types of institutions, including credit unions, savings banks, savings and loan associations, and money market mutual funds. The effectiveness of a voluntary disclosure program will ultimately depend on the willingness of other industry groups and associations to encourage their members to also make voluntary disclosures. It would be our hope and it has been our advice to the industry that they pursue their efforts with all due speed. If successful, these efforts will be the most effective answer for customers in allowing them to determine whether their institution's policies are reasonable and, if not, allowing them to take action to avoid problems.

Federal Reserve Program

The Federal Reserve Bank of Dallas is currently conducting a pilot program to test the feasibility of the Federal Reserve System returning a dishonored check directly to the bank of first deposit rather than back through each step in the initial collection route. It includes having the Federal Reserve provide wire notice to the last endorsing institution of nonpayment of checks in the amount of $2,500 or more during the first phase of the pilot, and in a later phase directly to the institution of first deposit. Direct returns could provide the framework for enabling depository institutions to provide faster availability to their customers. (Attachment C contains a more detailed discussion of the Dallas Return Item Project.)

The Dallas project is, however, currently limited to providing direct return of certain checks originally collected through the Dallas Reserve Bank to certain banks in the Dallas Reserve District and there may be operational and legal obstacles to expanding the pilot further. For example, five states and the District of Columbia do not permit the direct return of checks. The Federal Reserve is contacting the appropriate officials in those states to explore the possibility of stimulating changes in their laws to permit direct returns. If the results of the Dallas pilot demonstrate that direct returns will enhance payments mechanism efficiency and these state laws continue to be an obstacle, federal legislation could be appropriate to enable direct returns to be implemented on a nationwide basis.

Even if a nationwide system of direct returns can successfully be implemented, it is still somewhat unclear whether such a system would automatically result in better availability for the institution's customers. For example, if a direct return approach is to be effective in providing a framework for improved funds availability, it may have to be universal. That is, even if some or even most returned checks are sent back directly and quickly, if others are not, the institution of first deposit will not know in advance which items will be returned directly and which will be returned by the present indirect, time-consuming manner. As a result, institutions may be reluctant to provide the earlier availability that the direct return concept may facilitate. Because of this potential problem, an incentive may need to be established for institutions to use the direct return system or some method instituted to minimize the risk of loss to the institution of first deposit. Although many of the issues of operational and practical feasibility of direct returns are still unknown, the Dallas pilot should provide a great deal of information that will be useful in providing answers to questions on delayed funds availability.

Conclusion

In conclusion, the Board is very sympathetic to the need for disclosures by institutions to their customers. However, the industry is currently involved in efforts to accomplish this and we think the voluntary industry action should be given a chance to work. We know from experience that disclosure laws are easy to conceptualize but far more difficult to implement and, to the extent laws like this may impose unnecessary costs by forcing industry activity into a few approved formats, the customer may ultimately be the loser.

In the next year we will be gaining additional experience with our pilot project to speed up the return item processing, and will be in a better position to gauge the extent to which this program may ultimately reduce the delayed funds problem. Perhaps a federal disclosure law will ultimately be necessary, but given the industry's recent first step toward self-correction of the problem and this pilot program, we suggest that the Congress defer adopting formal legislation until an assessment can be made of their effectiveness.

The delayed funds problem should diminish as customers become more familiar with alternative forms of payments other than checks. Many payments, especially those that recur regularly such as salary, dividends, and Social Security, can be received through automated clearing houses, and others can be handled as wire transfers. We believe that electronic payments represent a more efficient, faster, and more reliable means of payment than paper transfers. We just published for comment several proposed enhancements to the automated clearing house service and are inviting the public to comment on how we can improve this service further. In essence, electronic payments are the only real solution to the problem of delayed availability. The Federal Reserve continues to be committed -- as it has been in the past -- to promoting the efficiency of the nation's payments mechanism through the development of electronic payments.

Attachment A

The Check Collection System

The check collection system in the United States frequently involves many handlings of a check between its deposit in one depository institution and its payment by the payor depository institution. Checks deposited to accounts in the same institution at which they are to be paid account for about 30 percent of all checks written. The remaining 70 percent of the checks must be collected by sending them to:

- a correspondent bank;[1]
- a Federal Reserve office;[2]
- a check clearinghouse;[3]
- the payor depository institution directly; or
- some combination of the above (the most likely alternative).

Most checks are collected within one or two business days and the bulk of the remaining checks are collected within three business days. The actual time required depends on the number and location of intermediary institutions involved and whether problems are encountered, such as mechanical breakdowns in transportation or sorting equipment, human error, or bad weather. Upon receipt of the check, the payor institution deducts funds equal to the amount of the check from the balance in the drawer's account if the check is properly drawn and endorsed, funds are available, and there is no stop payment order. If any of these criteria are not met, the payor institution sends the check back to its immediately prior endorsing institution. When a payor institution returns a check, it must do so by midnight of the banking day after the banking day it receives the check.

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[1] A correspondent bank is any depository institution that provides services and holds balances for other depository institutions.

[2] Federal Reserve Banks process approximately 35 percent of all checks written.

[3] A check clearinghouse is usually an association of depository institutions which may serve many needs of its member institutions including the exchange or clearing of checks.

The process whereby the unpaid check is returned to the institution of first deposit is, at the present time, quite complex and slow. Article 4 of the Uniform Commercial Code, which has been adopted in all states, governs check clearing, including the return of unpaid items. Most of the state laws include a provision that permits the payor or collecting institution to return a check directly to the institution of first deposit. Several factors, however, discourage the use of the direct return procedure. Several states have not adopted the U.C.C.'s direct return provision.[4] If either the institution of first deposit or payor institution is located in one of those states, the payor must obtain the institution of first deposit's agreement to a direct return -- itself a costly and time consuming process. Further, if the institution of first deposit and payor institutions do not have accounts with each other or with a mutual correspondent, it may be difficult for the payor to get a refund for the check; under such circumstances, it is far simpler to return the check to the presenting institution and charge back the amount. Because of these factors, institutions almost universally return dishonored checks to the immediately preceding institution in the collection chain. Thus, if several institutions were involved in the clearing process, each of these institutions will also handle the check as it is returned to the depositor.

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[4] All states except Nebraska, Nevada, New Jersey, Oregon, Wisconsin, and the District of Columbia have adopted the optional provision of the U.C.C. allowing direct return of dishonored checks.

Although the processing of return items is the reverse of the original processing for collection, this process is much more labor intensive. The machine readable coding at the bottom of the check allows for collection routing through the use of computer controlled high speed check sorters. A check being returned, however, must be processed manually because each endorsement stamp on the back of the check must be read to determine the institution to which the check should be returned. These endorsements are not machine readable. As a result, return routing might typically require twice as much time as collection routing. For example, a check requiring two days to be delivered to the paying institution might require four additional days to be returned to the institution of first deposit.

Approximately 1 percent of all checks the Federal Reserve collects--about one-half million checks per day--are returned unpaid. Unfortunately, at the time a check is first deposited, there is no way of knowing whether it will be paid or returned.

Correspondent institutions and the Federal Reserve grant depository institutions credit for checks that they receive for collection using an availability schedule which reflects the normal processing and transportation time involved. However, reflecting the uncertainty regarding a check being paid or returned, the credit granted is provisional, and the institution receiving the credit must be prepared to give it up immediately should the check be returned unpaid. Likewise, depository institutions' depositors must also be prepared to make restitution of any funds credited to their account should a deposited check be returned unpaid. This is true, even though a delay in availability may have been imposed and even though that delay period has expired and the customer no longer has the funds in the account.

Attachment B

Summary of Survey Research Center Survey of Consumer Experience with Delayed Funds Availability

Introduction

Several questions probing consumer experience with delayed availability of funds deposited in checking, savings, and money market deposit accounts were included in the March 1983 Survey of Consumer Attitudes conducted by the Survey Research Center (SRC) of the University of Michigan under the Board's contract with SRC. This summary reports the results of the March survey and compares the March data with results from similar surveys conducted during 1977 and 1981.

Summary

The March 1983 survey indicates that the large majority of deposit account holders did not have delayed availability problems in the past few years. Of the respondents who had problems, few reported that the problems occurred frequently; most indicated that delayed availability problems occurred very infrequently.

The proportion of deposit holders with frequent delayed availability problems has not increased since 1981, while the proportion of deposit holders reporting occasional problems decreased slightly. Respondents to the 1983 survey were less likely to report that the problems were associated with new accounts than respondents to the November 1981 survey.

One-quarter of deposit holders reported that they have accounts at financial institutions that have delayed availability policies. Many of these respondents learned about the policy when they had problems, but most learned about the policy from a written disclosure, verbally from the teller, from a friend or relative, or some other way. The remaining three-quarters of deposit holders reported that the institutions where they have accounts do not have delayed availability policies or that they did not know whether any of the institutions where they have accounts have such policies.

Reported Problems With Delayed Availability of Deposited Funds

Eleven percent of respondents to the March 1983 survey who had checking, savings, or money market deposit accounts reported problems with delayed availability of deposited funds in the last few years (Table 1). However, only 2 percent of deposit holders indicated that they had delayed availability problems frequently (once a month or more). In comparison, 20 percent of deposit holders responding to the August and November 1981 Surveys of Consumer Attitudes and 12 percent of checking account holders responding to the 1977 Consumer Credit Survey reported delayed availability problems. Four percent of deposit holders in 1981 and 2 percent of checking account holders in 1977 said that delayed availability problems occurred frequently.1/

Experiences With Delayed Availability Problems

In 1983, two-thirds of the respondents who reported delayed availability problems indicated that the problems occurred once a year, only one or two times, or one time only in the last few years (Table 2). Forty-three percent

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1/ In 1977 and 1981, respondents were asked whether delayed funds availability policies caused them to have problems frequently, sometimes, hardly ever, or never. Respondents to the November 1981 survey were also asked to indicate whether the problems occurred once a month, once a year, only one or two times, or some other number of times. Most respondents who reported frequent delayed availability problems said that the problems occurred once a month or more.

of the respondents who had problems said that the problems occurred because they were unaware of the policy. Other reasons mentioned included record keeping mistakes by respondents, errors by financial institutions, and out of state checks. Fifteen percent of respondents with problems indicated that the difficulties were with new accounts. Sixty-three percent of respondents with problems contacted the financial institution about the problem. Of these, nearly half reported that the institution was helpful in solving the problem.

Responses to questions about the frequency and reasons for delayed availability problems in the November 1981 survey were nearly identical to those in the 1983 survey. However, problems were more than twice as likely to have been with new accounts in 1981. In addition, respondents to the November 1981 survey discussed the problem with the financial institutions more often and were more likely to report that the institution was helpful in solving the problem.

Awareness of Delayed Availability Policies

The 1983 survey contained additional questions on awareness of delayed availability policies. Twenty-five percent of the deposit holders responding to the survey reported that they have accounts at financial institutions that have delayed availability policies; 64 percent reported that the institutions where they have accounts do not have delayed availability policies. (Table 3). The remaining 12 percent of deposit holders said that they did not know whether any of the institutions where they have accounts have delayed availability policies. Of the 147 respondents who reported having accounts at institutions with delayed availability policies, 46 percent learned about the policy when they had problems, 19 percent were informed verbally about the policy by a teller, 13 percent learned about the policy from a friend or relative, and 12 percent received a written disclosure. The remainder reported various other ways of learning about the policy.

Table 1

Reported Problems With Delayed Availability of Deposited Funds, 1977-1983

	Number			Percent of deposit account holders		
	1977[1]	1981	1983	1977	1981	1983
Had delayed availability problems	257	243	68	12	20	11
Had frequent delayed availability problems [2]	32	44	13	2	4	2
Did not have delayed availability problems	1809	961	532	88	80	89
Total	2066	1204	600	100	100	100

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[1] Question asked only of checking account holders.

[2] In 1977 and 1981 response to question was frequently had problems. In 1983 response to question was had problems once a month or more.

Table 2

Experiences with Delayed Availability
Problems, 1981 and 1983

	Number		Percent of respondents who had delayed availability problems	
	1981	1983	1981	1983
Frequency of delayed availability problems				
Once a month or more	25	13	18	19
Few times a year	2	5	1	7
Once a year	21	8	15	12
Only one or two times	54	30	39	44
One time only	19	7	14	10
Other	17	5	12	7
Not ascertained	1	0	*	0
Total	139	68	100	100
Reasons for problems				
Unaware of policy	56	29	40	43
All other	75	36	54	53
Do not know, not ascertained	8	3	6	4
Total	139	68	100	100
Whether delayed availability problem was with a new account				
Yes	46	10	33	15
No	89	56	64	82
Do not know, not ascertained	4	2	3	3
Total	139	68	100	100
Whether institution was helpful in solving the problem				
Yes, helpful	57	20	41	29
No, not helpful	38	23	27	34
Did not discuss problem with institution	43	25	31	37
Not ascertained	1	0	1	0
Total	139	68	100	100

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*Less than 0.5 percent

Table 3

Awareness of Delayed Availability Policies, 1983

	Number	Percent
Institution has a delayed availability policy		
Yes	147	24
No	381	64
Do not know	72	12
Total	600	100
How respondents learned about policy		
Had problem	68	46
Received written disclosure	18	12
Verbally from teller	28	19
Friend or relative	19	13
Worked at financial institution	7	5
All other	5	3
Not ascertained	2	1
Total	147	100

Attachment C

The Dallas Return Item Pilot Project

The Dallas return item pilot, which began on February 24, 1983, consists of the following three phases:

Phase I

Under Phase I the Dallas Federal Reserve Bank began separately charging the payor institution for processing returned checks collected originally through the Federal Reserve. In addition, the Dallas Reserve Bank began notifying the last endorsing institution by wire that such checks of $2,500 or more were being returned unpaid.

Phase I demonstrated the operational feasibility of separately charging and providing wire notice for return items collected originally through the Federal Reserve System. Additionally, Phase I of the pilot program has been favorably received by payor institutions within the Dallas Federal Reserve District.

Phase II

Phase II consists of two stages. The first stage will begin shortly and continue through the end of 1983. During this stage, the Dallas Reserve Bank will continue processing and charging payor institutions for return checks previously handled by the Federal Reserve and continue to provide wire notifications. In addition, in this stage the Dallas Reserve Bank will do the following:

- In the case where both the returning institution and the institution of first deposit are located within the Dallas Federal Reserve District, the Federal Reserve will return the item and provide wire notification of large dollar items directly to the institution of first deposit.

- To encourage automation of return item handling, the Dallas Federal Reserve Bank will offer a special price for return items which have been specially prepared for processing on an automated basis.

In the second stage of Phase II, the Dallas Reserve Bank would expand the pilot to include checks collected originally outside the Federal Reserve if both the institution of first deposit and the returning institution are located within the Dallas Federal Reserve District. Prior to beginning the second stage, the Dallas Reserve Bank will obtain written agreements from collecting institutions within its District (with which the Bank has an account relationship) to accept returned checks collected originally outside the Federal Reserve and to pay for these items in immediately available funds.

Phase III

Phase III would open the pilot to all items. Where the bank of first deposit is located outside the Dallas Federal Reserve District; the check would be returned to the Federal Reserve office serving the institution of first deposit.

Senator HAWKINS. Our next witness is Mr. Ralph Christy, the Acting General Counsel of the Federal Home Loan Bank Board.

Mr. Christy, we appreciate your appearing today to give us the views of the Federal Home Loan Bank Board on the problem of delayed funds availability in savings and loans. We are running into a time problem. We have an exciting consumer panel following you, so as you heard earlier, because of time constraints, we would like you to summarize your statement in 5 minutes and we will enter your full statement in the record.

STATEMENT OF RALPH CHRISTY, ESQ., ACTING GENERAL COUNSEL, FEDERAL HOME LOAN BANK BOARD

Mr. CHRISTY. Good morning, Madam Chairman, and members of the committee——

Senator HAWKINS. Just a moment. Senator D'Amato has to leave and he has an announcement.

Senator D'AMATO. Madam Chairman, I want to compliment Professor Wechsler from Syracuse University School of Law, my alma mater, for preparing a magnificent statement. I believe it is precise and to the point and it addresses with specificity the problem areas, and suggests the manners and approaches to effectively address them.

Thank you.

Senator HAWKINS. Mr. Christy.

Mr. CHRISTY. I am pleased to appear before the subcommittee on behalf of the Federal Home Loan Bank Board to discuss the issue of delayed funds availability, an issue that concerns not only the financial institutions industry, but also the customers of that industry.

Institutions employ the practice of placing holds on deposited checks because of the structural features of the present check collection system, to protect themselves in the event an item is not honored by the institution upon which the check is drawn, because at each clearance step, until honored by the institution, only provisional credit is given.

Although the practice of delaying consumers' access to their deposited funds has become an element of concern, and some institutions may impose undue delays, we believe the real problem lies in the customers' lack of information about the specific hold policies of their institutions as well as their misperception of their institution's ability to clear checks quickly.

Even in this day of electronic banking, the check clearance system still entails the physical movement of deposited instruments from the depository to the drawer institution in order to be cleared. Until that system is streamlined, with possible attention to modifying the Uniform Commercial Code, some delays must be expected.

CHECK CLEARING POLICIES SHOULD BE MADE KNOWN TO CUSTOMERS

Moreover, we believe most complaints that institutions are playing the game in order to improve their earnings at the expense of customers are not well-founded, at least with respect to the standard practices in the thrift industry. Savings and loan associations here have traditionally paid interest from the date of deposit to the date of withdrawal, rather from the date on which they receive provisional credit. In fact, in many instances if deposits are received prior to the 10th of the month, interest will be credited from the first of the month.

Regardless of the justifications for current practices, however, we believe the first step toward alleviating the perceived and real problems of the consumer is the education of and the disclosure to the consumer of an institution's check clearing policies in a complete, easy to understand manner. We strongly endorse the concept that institutions should provide information directly to customers concerning funds availability policies. To the extent, then, that the institution is arbitrarily delaying availability of funds beyond the minimal time dictated by the Uniform Commercial Code and the Federal Reserve clearance system, competitive forces will act in the marketplace and the customers will be able to exercise a choice.

Second, institutions should train their employees so they are able to answer general customer inquiries and provide general information concerning the availability of deposited funds. In this manner institutions can establish a better environment for their customers.

However, given the relative ease by which institutions could alleviate the concerns over hold policies, we have reservations about the need for and the likely benefits of Federal legislation at this time.

While we fully endorse the overall purposes of S. 573, the Fair Deposit Availability Act, we are concerned that the legislation may have a potentially adverse impact on financial institutions, particularly thrifts, in that it could substantially increase their operating costs and have adverse influences on operating efficiencies which could, in fact, reduce the benefits which the bill is designed to provide to consumers. The cost of such services and reporting ultimately may be reflected in higher costs to the consumer.

If Congress believes the legislation is necessary to address the problem of inadequate disclosure, we would propose an alternate approach and limit the required disclosure of "hold" policies to the time when an account is opened. This should significantly reduce the number of consumer complaints and misunderstandings and, at the same time, minimize the cost of disclosure.

For several reasons we also have reservations concerning the requirement that institutions require specific notice at the time of deposit as to when deposited items may be available for withdrawal. Such a requirement would generate new legal issues and operational problems for institutions. Extensive training of personnel in the workings of the Fed's clearance system and questions of liability may increase the time and cost of processing the average transaction, to the detriment or inconvenience of the customer.

We believe the proposed requirement that the payor institution, upon a determination to dishonor any item of $250 or more notify the original depository institution within 24 hours of such determination, will be overly burdensome and costly to the industry, and ultimately to the consumer. The lower trigger amount will substantially increase the number of notifications required, which in turn will increase the required staff and facilities, all of which will increase the cost of handling returned items. We believe this cost should not be borne by all consumers, but only by those who were responsbile for the problem.

Second, the proposal appears to bypass the Federal Reserve Board's communication network, which may create duplication and inefficiency, at least until the Fed's experimental process about which Chairman Martin has spoken is operative nationwide. The Board looks forward to working with the Congress and the industry to improve the current situation, and to reduce the delay for consumer access to their deposited funds.

We believe, though, where institutions provide adequate disclosures of their policies or pay interest or permit withdrawal of deposited funds, the operation of the deregulated competitive market would produce beneficial results over the long run and would eliminate the need for additional legislation.

If, however, such results do not occur, then we would recommend and endorse imposing more substantative requirements on financial depository institutions to change their present practices.

[The complete statement of Mr. Christy follows:]

STATEMENT OF RALPH W. CHRISTY, ACTING GENERAL COUNSEL OF THE FEDERAL HOME LOAN BANK BOARD

Madam Chairman, Members of the Subcommittee, I am pleased to appear before the Subcommittee on behalf of the Federal Home Loan Bank Board to discuss an issue of concern not only to the financial institutions industry but also to the customers of that industry -- delayed funds availability. To that end, my comments will focus on the causes of and the problems encountered by the practice of delayed funds availability, progress made toward ameliorating customer complaints arising from abuse of this practice, the necessity of federal legislation at this time, and the impact of the proposed legislation upon the savings and loan industry.

Delayed funds availability is descriptive of the practice of financial depository institutions by which the depositor of a check or like instrument is not permitted to write drafts on or make cash withdrawals from the funds represented by that instrument until some fixed period of time after the institution itself has received credit for the deposited item.

Financial institutions commonly employ this practice due to the structural features of the present check collection system, sanctioned by the Uniform Commercial Code and established and operated by the Federal Reserve Board (including regional check processing centers). Under the present system of processing checks, every check that is deposited at a financial institution is moved from the institution where it is deposited back to the institution on which the instrument is drawn. Usually, the process entails passage of the check through several "interim" or collection banks in the clearing system before it finally reaches the drawer institution. Each collection bank has until midnight following the date of presentment of the check by the preceding bank either to honor (by granting of provisional credit) or to give notice of dishonor of the collected item. (U.C.C. § 4-301) Each collection bank normally gives the preceding bank a provisional credit for the deposited item, but reserves the right to revoke that credit if that item is returned (because of insufficient funds, forgery, or the like).

In order to protect themselves in the event that an item is not honored by the drawer, banks, thrifts and other financial institutions place "holds" upon the deposited checks to allow sufficient time not only to protect themselves from fraudulent check writers but also to assure the institution's receipt of provisional credit. In many instances the "hold" policies of institutions may vary, depending upon the type of instrument deposited (personal, corporate or government check), the geographic location of the institution on which the check is drawn (intrastate or interstate), the amount deposited or the identity of the depositor (new accountholder or established customer).

While most institutions view this practice as a necessary element of doing business, problems may arise if the their customers are not notified of the institutions' hold policies. Unfortunately, the typical customer who deposits a check or like item may not be fully aware of the complexities of commercial paper transactions, and particularly with what is involved in the complicated network of the movement of commercial paper. Thus, the customer who deposits a check into his or her account assumes that the deposited funds are accessible, and may immediately write checks based on that assumption. When the customer's checks are returned as unpayable because of "uncollected funds," the customer is bewildered and angry because of the embarrassment of returned checks due to his or her lack of knowledge of the institution's delayed funds policy.

Critics of delayed funds or hold policies charge that, given the era of electronic banking technology and automated clearinghouses, financial institutions are playing the "float" game -- earning interest during the interim period between provisional credit and release of the hold on customers' deposited checks -- in order to make a profit rather than to protect the institution from unpaid items.

Some institutions, including savings and loan associations regulated by the Bank Board, maybe imposing undue delays in making funds available to customers. However, we submit that the harsh complaints raised by individuals and consumer groups are not always justified for several reasons. First, because of the lack of knowledge, customers have developed incorrect notions about financial institutions' ability to clear checks in short periods of time.

Ironically, many of these perceptions can be traced to the industry's efficiency. In an age where institutions can move different currencies around the world or allow customers to deposit and withdraw funds at the push of a few buttons, it is understandable that customers would question the justification for delayed funds availability. Yet, even in these days of electronic banking, checks, NOW instruments or share drafts do not clear overnight. In fact, most deposited instruments must physically travel to their home, or drawer, institution in order to be cleared. This process may take several days for a local item to clear, and longer for an out-of-state item. Thus, financial institutions have a legitimate concern that must be met: the receipt of payment from the payor institution, prior to making the deposited funds available to its customers.

Second, in answer to the criticism that institutions do not begin computing interest on customers' deposited funds until the institution has received final payment on the deposited item, the Board believes that this charge is simply not true with respect to the standard practices of savings and loan associations. Thrifts have traditionally paid interest from the date of deposit to the date of withdrawal, rather than from the date on which they receive provisional credit. And, in some instances, associations pay interest on deposited items from the first of the month if that deposit is received by the tenth of the month.

Regardless of the justifications for current practices, however, the Board believes the first step toward ameliorating perceived problems is the education of and disclosure to the consumer of an institution's check clearing policies in a complete, easy to understand manner. This, in turn, should alleviate many customer complaints and enhance customer relations with the institution with whom they do business.

We strongly endorse the concept that financial institutions should take it upon themselves at the outset of a customer relationship to disclose their policies on delayed funds availability. Institutions can achieve this objective through two primary avenues. As a first concrete action, institutions can provide information directly to customers concerning funds availability policies. The methods can take many forms: statement stuffers and consumer cards to explain policies, disclosure books to customers opening new accounts, or posting terms of availability throughout main offices and branches. This serves the purpose of informing and, at the same time, educating the customer. With this information, an educated customer can compare the policies of various institutions and can decide which institution's policy is most advantageous to his or her needs. This, in turn, will increase the competitive forces in the marketplace, as institutions will have to demonstrate good faith efforts to provide customers with access to their funds in a reasonable time or else run the risk of losing customers to institutions which may provide the funds in a more timely manner.

Second, financial institutions can educate their staffs to answer customer inquiries concerning the availability of deposited funds. Such an internal education program need not require a thorough working knowledge of the Federal Reserve Board's clearance network (such as which checks will clear through which district banks, or the exact time periods needed for clearance of particular items). Rather, where personnel are educated and encouraged to answer general questions or to provide general information about the institution's hold policies, the institution can establish a better environment for its customers by showing a willingness to cooperate and to eliminate confusion.

Given the relative ease with which institutions can ameliorate concerns over hold policies -- through adequate communication to customers of funds availability policies -- the Bank Board has reservations about the need for, and likely benefits of, federal intervention, by legislation or regulations, at this time. Specifically, the Board is concerned about the potential adverse impact that S. 573 may have on financial institutions, particularly thrifts, due to operational changes which would be required and the cost of implementing those changes to the present system.

S. 573 addresses the practice of delayed funds availability and would: (1) provide for consumer access to funds upon the receipt of provisional credit by the depository institution; (2) require institutions to inform customers of their hold policies both at the time a person opens a new account and at the time the person deposits a check if the funds will not be available immediately; (3) require the drawer institution to notify the payor institution within 24 hours of the time that the drawer determines that a check of $250 or more is not payable; (4) require financial institutions to begin computing interest on deposits to interest bearing accounts no later than the date on which the institution receives provisional credit for the deposited item; and (5) mandate that financial institutions use the standard on "specification of check endorsements" devised by the American National Standards Institute.

The Bank Board fully endorses the overall purposes of the legislation. However, based on our experience with the operating practices of savings and loan associations, we believe the provisions of S. 573 could substantially increase the operating costs of thrifts, and have adverse influences on operating efficiency which could, in fact, reduce the benefits which the bill is designed to provide consumers. Moreover, the cost of compliance required by the legislation could adversely affect thrift earnings at a time when the thrift industry is still in a very fragile economic condition, as a result of the recent economic crisis.

Addressing the specific provisions of the bill, if Congress believes that legislation is necessary to address the problems of inadequate disclosure, we would propose an alternative approach which would alleviate many consumer complaints and, at the same time, maximize the ability of financial institutions to provide more efficient availability of funds to its customers. We would, therefore, recommend limiting the disclosure to the time when an account is opened and, if the institution subsequently alters its funds availability policies, to provide notification to its customers at least thirty days in advance of any such change. If proper notification is given, then printing costly and cumbersome schedules of funds availability on deposit slips, envelopes for automated teller machines, etc., as required by the legislation will not be necessary.

For several reasons we also have reservations concerning to any requirement that institutions provide specific notice, at the time of deposit, as to when deposited items may be available for withdrawal because of the significant burdens it will impose not only on thrifts but also on the entire financial institutions. First, such a mandate may generate new and substantial operational problems for institutions which are not addressed by the legislation.

For example, the proposal would entail additional and costly training of personnel by institutions, so that each teller would have immediate access to and knowledge of the Federal Reserve Board's nationwide transit routing system, and how each check cashed or accepted for deposit will travel through that system. We believe that such responsibilities are beyond the realistic scope of the normal duties of such an individual. Second, if a teller is required to disclose the availability of funds on every transaction involving the deposit of a check, then the time for processing the average transaction will increase, to the inconvenience of the customer. What could foreseeably occur is that financial institutions would adopt a policy of processing only "local" items on high volume business days, such as corporate pay days or social security days. This could lead to increased holds on items not falling within those categories, again to the detriment of customers. We believe that a workable alternative is a general education of institution personnel so that they can answer customer inquiries or provide general information concerning the institution's hold policies as to the type of item deposited.

Perhaps the most onerous impact upon thrift operations, in terms of cost of compliance and disruption of services, is the proposed requirement of direct notification within 24 hours by the payor institution, upon determination of nonpayment of any item $250 or more, to the original depositing institution. The effects of this change from current practice are twofold. First, because of the lower trigger amount required for notification (from $2,500 to to $250), the number of such notifications will increase substantially, which in turn greatly increases the cost of handling return items. Based upon data provided by the Federal Home Loan Banks regarding the current volume of NOW account transactions by thrifts, it is projected that the number of notifications will increase tenfold. This in turn will mean an increase in the number of staff and facilities in order to handle this operation. In practical terms, the cost of operation will be passed onto all consumer users in the form of fees or reduced interest credits and, may likely offset any benefit of expediting assessibility to funds. Second, the proposed legislation requires financial institutions to contact directly the original depository institution, thus bypassing the Federal Reserve Board's communication network. Presently, return items are directed back to the last paying bank, quite often the local Federal Reserve Bank, with notification to the Federal Reserve Bank only on items over $2,500.00. The new requirement not only seems to be inefficient in light of the Federal Reserve Board's system, but also imposes upon the payor bank the obligation to notify any one of over 20,000 financial institutions throughout the United States of any return item over the lowered trigger amount. Thus, the potential for creating an unwieldy and expensive system, rather than one of efficiency, appears to be the likely outcome.

Our final reservation concerning S. 573 is the requirement that financial institutions begin computing interest on deposits no later than the date on which the institution receives provisional credit for the deposit. As was mentioned earlier, savings and loan associations traditionally have begun accrual of interest on funds in interest bearing accounts as of the date of deposit. Moreover, because the thrift industry is a relative newcomer in the transaction account business and instituted its NOW accounts in a highly competitive environment, we do not believe that the practice of delaying interest accrual while earning interest on the "float" is prevalent. We also believe that any provision mandating interest crediting is contrary to the recent and successful deregulation effort and is unnecessary in a competitive marketplace. We would suggest that the preferable alternative is to allow financial institutions to determine when interest will be credited, provided there is sufficient disclosure of the institution's policy to the consumer.

The Board looks forward to working with the Congress to improve the current situation of delayed consumer access to deposited funds. We would suggest, however, that where institutions provide adequate disclosure of their policies on paying interest or permitting withdrawals on deposited funds, the operations of deregulated, competitive markets should produce similar results as the proposed legislation over the long-run. If such results do not occur, then we would recommend and endorse imposing more substantive requirements on financial depository insistitutions to change present practices.

Senator HAWKINS. Thank you, Mr. Christy. I have no questions. Do you have questions, Senator Dodd?

Senator DODD. Did you address, Mr. Christy—I apologize if I missed it—the ANSI standard, the issue of putting on the back of the checks, to assist——

Mr. CHRISTY. It is addressed in our written comments, Senator Dodd. We endorse a uniform nationwide standard.

Senator DODD. Are you familiar with the standard recommended by the ANSI?

Mr. CHRISTY. I believe we are. This has not been an item until recently that the thrift industry would have been deeply involved in because of the nature of our transactions. With the beginning of NOW accounts and so forth, it will become more of a problem for the thrift industry.

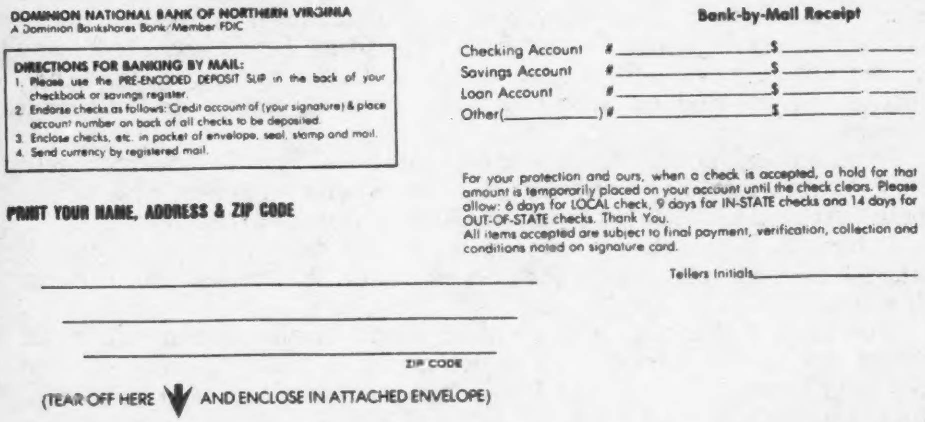
Senator DODD. I will ask this be inserted in the record. The Dominion National Bank of Northern Virginia, on its own, uses a standardized form of disclosure, and they have a very simple deposit slip. The disclosure is a small item that they include, which looks very simple, not terribly complicated.

I appreciate your comment about the disclosure at the outset when the account is opened. That is certainly a positive step and there certainly is a legitimate question to be raised about the additional cost of printing that kind of information on a deposit slip. There may be others across the country that do this, but in this particular instance, it looks fairly simple to accommodate that, one or two sentences really. It says "Please allow 6 days for local checks, 9 days for in-State checks, 14 days for out-of-State checks."

That is not terribly complicated, and it is fairly clear.

Anyway, we will put that in the record.

[The document follows:]



DOMINION NATIONAL BANK OF NORTHERN VIRGINIA
A Dominion Bankshares Bank/Member FDIC

DIRECTIONS FOR BANKING BY MAIL:
1. Please use the PRE-ENCODED DEPOSIT SLIP in the back of your checkbook or savings register.
2. Endorse checks as follows: Credit account of (your signature) & place account number on back of all checks to be deposited.
3. Enclose checks, etc. in pocket of envelope, seal, stamp and mail.
4. Send currency by registered mail.

PRINT YOUR NAME, ADDRESS & ZIP CODE

ZIP CODE

(TEAR OFF HERE AND ENCLOSE IN ATTACHED ENVELOPE)

Bank-by-Mail Receipt

Checking Account #________ $______ . ___
Savings Account #________ $______ . ___
Loan Account #________ $______ . ___
Other(______) #________ $______ . ___

For your protection and ours, when a check is accepted, a hold for that amount is temporarily placed on your account until the check clears. Please allow: 6 days for LOCAL check, 9 days for IN-STATE checks and 14 days for OUT-OF-STATE checks. Thank You.
All items accepted are subject to final payment, verification, collection and conditions noted on signature card.

Tellers Initials________

Senator HAWKINS. Thank you.

Our next panel includes Prof. Steven Wechsler, from Syracuse University College of Law, Syracuse, N.Y.; Gayle Essary, People, Inc., Flushing, N.Y., and Ellen Broadman, Consumers Union, Washington, D.C.

In the interest of time, please give us a brief summary of your statement, then we will have questions. Mr. Wechsler.

STATEMENT OF PROF. STEVEN WECHSLER, SYRACUSE UNIVERSITY COLLEGE OF LAW, SYRACUSE, N.Y.

Mr. **Wechsler**. Thank you, Madam Chairman. I would like to thank Senator D'Amato for his kind remarks.

As you have indicated, lengthy delayed funds holds are indeed a burden on depositors. In our present environment, they are also necessary to protect banks from the risk of severe loss on returned checks.

The length of those holds is tied to the length of time that is necessary for a check to be deposited, to reach the payor bank and, in the event it is returned, to make the long trip back. That can sometimes take 2 or 3 weeks under the present system.

The slowness of that return in the system as presently constituted is due to a number of factors. First of all, the check has to pass through the exact same stream of banks as it journeyed over on its outward trip.

Second, it has a midnight deadline at each, which means each bank gets until midnight of the next day to pass it on.

Moreover, as I believe you pointed out, Senator, no bank has an incentive to speed this process up, although there is a strong incentive to speed up the forward process.

Also the entire return trip is handled manually, rather than in a high-speed mechanical automated manner. If we could speed up the return trip, we could require banks to release funds more quickly. Fortunately, it is possible to do that, thus giving consumers their money more quickly without exposing banks to increased risk of loss.

I believe it has to be handled at the national level, however. The new legislation, in New York and in California, may well result in shorter delay in those States, but because no State has the power to regulate other States' banks or the national bank system, banks located there indeed may suffer increased losses on returned checks.

In addition, as has been pointed out here, State regulation will lead to an uneven patchwork of laws, with consumers and banks being treated differently from one jurisdiction to another.

I think S. 573 makes a very good start on the problem. In particular, I like the provisions for the payment of interest and for disclosure.

However, I think it is clear that many banks already do both. Those provisions, therefore, are not going to make a major change from what we have now and will give only limited help to depositors.

My criticisms of S. 573 are threefold. First of all, it only does half of the necessary job as I see it. The provision for direct notification has the effect of speeding up the return trip. But there is nothing in the bill which requires banks to release funds any more quickly than they now do, and I am not sure they will do so on their own. The statute should make sure that depositors get the benefit of the speeded up return trip.

Second, there is the $250 notification floor. Studies indicate that the vast majority of checks are less than $250, indeed less than $100. A $250 floor strikes me as probably too high to help many depositors. If we set the floor at $100, we would still exclude a great many checks, perhaps as many as 65 percent or more. But we would include more than the $250 floor does and the bill would be more helpful to the average customer.

Third, the bill imposes this requirement of direct notification, which may indeed prove to work very well. However, we are dealing with a very complicated technology here, and I believe the statute should set the broad goals and should leave the fine tuning to the expert regulators who are closest to the problem. It might, for example, turn out that direct return of checks is more beneficial than direct notification. This bill would lock the industry into direct notification.

What I propose is this: I believe the Board of Governors of the Federal Reserve System should be charged with issuing regulations. Mr. Martin said he cannot do that under the present law. If necessary, then a statute could direct the Board to issue regulations on this subject. Those regulations would first significantly speed up the return trip of checks. They would do that by using the new endorsement standard that has been mentioned here, and would require either direct notification or direct return or perhaps both operating side by side, as future experience dictates.

All of these details, such as the appropriate amount, the methods to use, and also a phasing in schedule to allow the banks to adjust their computer programs could be left to the Board. At the same time the Board was taking action to speed up the return trip, you should require banks to reduce their delayed funds holds, so they are in line with the now accelerated return times. Schedules for funds release would be developed reflecting the different sizes, locations, and clearing practices of different banks.

As you have indicated, Madam Chairman, I think that Government, bank, and certified checks should be handled for particularly rapid crediting. On the other hand, new accounts and those with a troublesome prior history of bad returns could be treated with appropriate caution.

Mention has been made of the cost of doing all of this. It is quite possible there would be increased costs, although it seems to me that direct return might merely trade off some costs for those that are presently in the system. I understand it is quite expensive now to handle these returns manually.

In any event, if there were increased costs I believe they should be passed along to the people who caused them, rather than borne by all depositors. These could be collected via return check fees, which are already charged, from the depositors and eventually the drawers of returned checks. If there were any remaining risk of loss on the banks, even though the return trip were speeded up, we might explore the idea of an insurance fund to further protect banks. However, again, these details should not be engraved in stone in the statute, but should be left to regulation, so there could be flexibility as experience indicates.

[The complete statement of Professor Wechsler follows:]

STATEMENT

OF

STEVEN WECHSLER

ASSOCIATE PROFESSOR

COLLEGE OF LAW

SYRACUSE UNIVERSITY

SYRACUSE, NEW YORK

I am pleased to have the opportunity to present my views on Delayed Funds Availability to this Subcommittee. I believe that the banking industry's widespread current practice of delaying the availability of funds deposited by check for periods of time ranging from a day to two weeks or more is fully justified by the current system of check collection and return. At the same time I am convinced that changes in that system can be made that will permit banks to release deposited funds much more quickly, without putting the banking community at risk. A clear understanding of the problem suggests a practicable solution, which must be handled on a national level and which must address the cause of the problem and not merely its symptoms.

What Delayed Funds Availability Is And Why Banks Need It

Delayed Funds Availability ("DFA") is a policy adopted by many banks whereby funds deposited by check are not available for withdrawal by the depositor until sufficient time has passed so that the depositary bank can be reasonably certain that the check will not be returned to it. The purpose of DFA policies is to avoid or minimize bank losses caused by the return of checks where recovery from the depositor might be difficult, costly or impossible.

While only about 1% or less of all checks deposited are returned, and while more than half of those are for relatively small amounts (64% were under $100 according to a 1973 study), depositary banks are subject to the prospect of any given check being returned. In addition, although most checks reach the payor bank in a relatively short time, the total round trip for a returned check can sometimes take as much as three or four weeks. Moreover, no affirmative notice that a check has been paid is ever given; the depositary bank can only assume payment after a sufficient time has elapsed so that it feels relatively certain that the check will not come back. In order to protect themselves against the 1% of checks that are returned, many banks have adopted a policy of withholding the availability of deposited funds for some period of time, pending that assumption of collection. The Uniform Commercial Code recognizes the right of the depositary bank to withhold funds in this manner in Section 4-213 (4), which states that "...credit given by a bank for an item in an account with its customer becomes available for withdrawal as of right ... when (the provisional) settlement becomes final and the bank has had a reasonable time to learn that the settlement is final...". The Official Comment to this Section indicates that "how much time is 'reasonable' for these purposes will of course depend on the distance the item has to travel and the number of banks through which it must pass (having in mind not only travel time by regular lines of transmission but also the successive midnight deadlines of the several banks) and other pertinent facts." Uncollected funds delays based on this statute have been upheld by the courts.

Although only about 1% or less of all deposited checks are returned unpaid, although the depositary bank still has a right to collect such returned checks from its depositor, and although losses from returned checks are relatively small (about $5,000,000 industry-wide in 1973), the banking industry needs to protect itself by placing holds on deposited checks. Indeed, the very reason that losses have been small is in large part attributable to the existence and imposition of DFA policies. Without such policies (or with significantly shortened hold periods) bank losses, particularly those attributable to illegal and fraudulent activities, might be greatly increased. Viewed in the light of the present check collection and return system, DPA policies may be seen as a symptom rather than an underlying problem. Indeed, DPA is both a sensible and necessary policy under the current system. The real problem is the extreme slowness that is often encountered in the return of checks to depositary banks.

Why The Trip Takes So Long

The Forward Trip

The physical movement of checks from depositary banks to payor banks through the check clearing process is a high speed, highly automated, technically sophisticated process. Each bank is assigned unique routing and transit numbers, which are preprinted on the check in machine-readable, magnetic characters. Computer-controlled high speed check sorters quickly move checks on their forward trip towards the payor bank. Special land and air couriers are used, which also speed this forward journey. A check may need as few as one intermediate stop or as many as five or six, depending on the locations and sizes of the depositary and payor banks involved. Checks deposited in savings banks require one extra stop, as these banks generally collect checks through a correspondent. Each stop may take as little as half a day to as much as one and a half days. The actual length of the outbound trip from depositary to payor may thus take as little as one day or as much as six or more days. While mechanical, transportation or other difficulties could conceivably lengthen this time frame, it appears that the vast majority of checks reach the appropriate payor banks in only two or three days. A 1979 Check Flow Model, based on an exhaustive study by the Atlanta Federal Reserve Bank, projected that about 80% of all checks were received by the second day; by the end of the third day, about 98% had been received. While these checks were still subject to being returned by the payor bank for a further 24 hours, their forward journey was complete. Considering that the national check processing system handles some 35 billion checks per year, the forward journey of checks is remarkably fast and efficient, and is not likely to be significantly improved, absent a sudden and unexpected shift to electronic funds transfer.

The Return Trip

Upon receipt of a check presented to it, a payor bank has until midnight of the next business day to either pay the check or to send it back and revoke the provisional credit previously given. Possible reasons for such refusal to pay include insufficient funds, account closed, endorsement errors, payment stopped, post-dated check and uncollected funds hold. Of these, insufficient funds and account closed are the most significant. Whatever the reason, prior to the expiration of the midnight deadline, the payor bank has the unequivocal right to dishonor the check and revoke its provisional credit. This is typically done by returning the check through the U.S. mail to the previous bank in the delivery chain and concurrently revoking the credit given. That bank likewise has until midnight of the next banking day to return the check to the bank it received the check from and to revoke its provisional credit. Two things are immediately apparent about this return process. First, although the object of the process is to reverse the ultimate credit and debit in the respective accounts at depositary and payor banks, the check must wend its weary way back the exact same path it followed on its outward journey. Second, as the check moves backwards up the chain of delivery, revoking earlier granted provisional credits as it goes, each way station has until midnight of the next day to pass it on.

On the forward journey of the check, each bank handling it was anxious to pass it along as quickly as possible in order to get the use of the provisional credit. No such incentive exists for the return trip. Furthermore, not only must the returned check move backwards up its original path, pausing for the midnight deadline at each stop, but the journey is lengthened by a number of technological and mechanical factors. While the forward journey of the check was accomplished at relatively high speed by virtue of automated, computer-controlled machine-reading check sorters and special dedicated land and air carriers, the return journey is fairly characterized as being the exact opposite. The check is manually processed at each stage of its handling. Clerks in each bank must carefully decipher the stamped endorsements on the reverse of the check to see where it will be sent next. Often these endorsements are printed one on top of another and are virtually unreadable. This process is made even more difficult for those checks which have been re-deposited after being returned once, and now bear a double or even triple series of endorsements. Neither magnetic numbers nor high speed computerized machinery are used. Nor are special couriers utilized: most returned checks are merely deposited in the U.S. mails and are subject to all the vagaries of bad weather and mechanical breakdowns. The entire check return procedure is an antiquated holdover from a time when the volume of checks in the system was considerably smaller.

This combination of procedural and technological factors makes the return journey of a check considerably slower than its outward journey. While the exact duration of the return trip may vary greatly depending on the location of the banks involved, the number of intermediaries and difficulties caused by transportation problems, a minimum estimate for the return trip is twice as long as the forward trip. In many cases, the return trip might take three, four or even five times as long as the outbound journey. The actual travel time can be dramatically lengthened by the intervention of one or more weekends or holidays.

Combining the length of time needed for the outbound trip with the period required for a check to be returned to the depositary bank is suggestive of the amount of time during which the depositary bank is at risk and must protect itself. The total length of the round trip might be as short as three days from one New York City bank to another or as long as twenty days for items deposited in a New York savings bank and drawn on a bank in another metropolitian area. Occasionally an isolated check could take even longer; in the Hearings held before this Subcommittee in March 1982 one New York bank reported a period of more than 33 days for the return of a single local check. It should be borne in mind that the largest part of these lengthy trips is found not in the automated outbound journey, but in the tiresome, manual return.

Adverse Impacts Of Delayed Funds Availability

In the present check collection and return environment, delaying availability of funds for reasonable, experience-based periods of time appears to be a legitimate response of bankers to what would otherwise be a serious problem with significant loss exposure. Nevertheless, DFA policies can have serious adverse impacts on depositors who are subjected to them. Hold periods on local checks run the gamut from no holds at all up to fifteen days or more, with every possible variation in between. For out-of-town and out-of-state checks the range of hold periods is again extremely diverse, with some banks requiring no hold period and others imposing holds of 21 days or more.

A depositor may encounter DFA holds in a number of ways: sometimes one is advised by the teller that a hold is being put on a deposited check; sometimes the bad news comes later, when the bank refuses to permit a withdrawal or bounces a check written against uncollected funds. In any case, the policy may cause inconvenience, annoyance, embarrassment and perhaps more serious problems to the depositor. In addition, bankers' attitudes on this point often cause depositors to feel resentful and frustrated. While representatives of the banking industry have attempted to minimize the problem by suggesting that few customers are in fact disadvantaged by holds, there are some objective indications that in fact a serious problem for bank customers does exist. Examples given in testimony before this Subcommittee in March 1982 and before the New York State Assembly Standing Committee on Banks in July 1982 show that the policy may adversely affect both individual consumers and small businesses. A particular inconvenience for some customers has occurred upon the sale of a house, with the proceeds being received in the form of a certified or bank check; upon moving to a new location elsewhere in the country, the former householder is amazed to find that this substantial sum of money is unavailable for the duration of his new bank's DFA hold period.

In addition to the inconvenience, embarrassment and actual loss that depositors are subjected to by DFA hold policies, they are also burdened by a sense of unfairness and frustration. Since about 99% of all checks are good and not returned, depositors may indeed feel aggrieved to be viewed with suspicion when they make a deposit. Consumer activists argue that it is unfair and unjust to penalize the depositors of the 99% of good checks merely to protect against the 1% of bad checks. Some characterize this policy as one that treats all depositors as guilty until proven otherwise, when in fact the overwhelming number of depositors are innocent in this regard.

Some depositors may resent what they perceive as discriminatory practices in the application of holds policies to various customers. When DFA holds are waived or varied for customers with large accounts, the small depositor (who is depositing a 'good' check 99% of the time) may indeed feel imposed on by the bank's refusal to accomodate him.

Another sore point for depositors and consumer activists involves the interest earned by the depositary bank during the hold period. Although many banks pay interest from the day of deposit on their interest bearing accounts, no interest is paid on the typical checking account. The suspicion that banks are making significant sums of money on their depositors' delayed funds strikes many as unfair and indeed deceptive, in that the depositor is forced into giving the bank a free or, in the case of interest-bearing accounts, a relatively low-interest loan.

The reaction of the banking industry to customers' problems with DFA has largely been to minimize the existence or extent of the problem and to suggest ways in which customers can reduce its deleterious effects. Bankers tend to characterize deposit holds as having little effect on their customers and emphasize their practice of paying interest from the day of deposit where permitted. They point out that customers may try to reduce the burden of DFA policies in a number of ways. These suggestions include maintaining large balances against which the customer will be allowed to draw immediately; arranging for a line of credit providing over-draft protection; increased use of electronic funds transfer and direct deposit; procurement of special treatment by making a request to a bank officer; and finally, choosing another bank with more pleasing policies. In addition, some banks have made the minor concession of allowing customers immediate availability of some small portion of deposited funds. Aside from the unfairness involved in imposing the entire DFA burden on customers, the tactics suggested by bankers are often less than helpful. The promised revolution of electronic funds transfer has not yet arrived; most transactions are still accomplished by the traditional transfer of a paper check.

Maintaining balances large enough to cover deposited items may be impractical for many consumers, who may also fail to qualify for the extension of overdraft protection. The availability of special treatment upon request of a bank officer may provide occasional relief, but it does require a special effort and may not be available to the average customer. Finally, the bankers' ultimate answer, that dissatisfied customers should take their business to the competition, is not at all helpful. Uncollected funds holds are so widespread as to be almost universal and within a given geographical area, the variation in policy from one bank to another is often nominal.

How To Handle The Delayed Funds Availability Problem

Basic Principles

(1) The delayed funds availability problem requires action on two fronts simultaneously. To require banks to allow withdrawal on a schedule that is any faster than the current return timing will impose increased risk of loss on the banking industry. Alternatively, merely to require banks to return checks more quickly will not necessarily improve the situation because there is no assurance that their DFA policies will change accordingly. The two techniques must be used together in order to provide customers with credit within a reasonable time and to protect banks from undue risk of loss.

(2) No state or locality can attack the problem on its own. Since no state has the power to regulate the check return process by out-of-state banks, the most a state can do is to require its banks to reduce their DFA hold periods. To the extent that such a change represents an improvement (for depositors) over current banking practices, that state's banks (which likewise have no control over the speed of returned items) will be subject to increased risk of loss. Moreover, state regulation may lead to an uneven patchwork of differing rules. To avoid these problems, any action taken must apply to all banks and to the national payments system. Clearly this suggests that the Federal government must be the one to regulate in this area.

A good example of the potential difficulties with state regulation is presented by a recently enacted New York statute. Under this new law (a copy of which is attached), the State Banking Board will promulgate regulations setting forth the maximum DFA hold periods permitted. This new law does not affect the return system itself. In cases where the allowed hold periods turn out to be shorter than the actual return times, New York banks will be exposed to the possibility of increased uninsured losses. In addition, the New York law applies to "retail" customers and may not help small businesses. A new California law may produce different treatment for depositors and banks in that state. Protection for all of the nation's depositors and banks can be achieved only through regulation at the national level.

(3) Requirements of disclosure and the payment of interest no later than the receipt of provisional credit are somewhat helpful, but they may effect little change from current banking practices. It appears that many banks already clearly disclose their DFA policies and pay interest from the day of deposit where permitted. Further, disclosure provisions will not necessarily lead to competition in this area due to the inability of banks to compete effectively; because each bank is subject to potential losses due to late returned items, no one bank can safely offer significantly shorter DFA holds than others in the same market area. Any differences presently seen are more likely due to differences in business judgment than to competition.

PROPOSAL

A practical solution to the problem of delayed funds availability is possible. Indeed, a clear understanding of the nature of the problem virtually compels an understanding of the necessary solution. The answer lies in a national effort, encompassing all banks. That effort must be a two-pronged attack on the problem. On the one hand, the national payments system must be charged with significantly reducing the length of the round trip for a returned check. This will then make possible a requirement that depositary banks allow withdrawal of deposited funds on an expedited schedule (keyed to the new round trip period) without exposing those banks to a significant risk of loss on returned checks.

Speeding The Round Trip -- Speeding The Return Trip

Speeding up the round trip of a returned check essentially means speeding up its return portion. The forward trip is automated and is probably as quick as current technology allows for. The lengthy delays in returned items are due to the cumbersome, manual handling of such checks, going backwards in the same series of steps that they made speedily on their forward journey. The methodology and technology for significantly reducing the return trip time is available; all that is needed is the will to go forward, and the details will follow.

The principal difficulties in the present return system are two-fold. First, there is the difficult problem of endorsement readability, caused by stamping endorsements one atop the other. In each bank, clerks must examine the series of stamped endorsements and attempt to decipher from whom the check was received. Second, there is the slowness caused by going back up the same chain of banks as used on the forward trip, but this time in a slow, manual process, with each bank taking up to its midnight deadline to pass the check on. Fortunately, both of these problems are readily soluble.

Endorsement Readability

Endorsement readability has already been addressed by the American Bankers' Association and the American National Standards Institute (ANSI). The new ANSI standard would require placement of endorsements in such a way that their readability was preserved. This would allow rapid identification of the depositary bank and thus facilitate the second necessary step of avoiding the circuitous return trip. Use of machine-readable characters in the endorsement by the depositary bank might also be considered.

Payor To Depositary: Direct Routes

Use of a series of banks in the forward collection system is an absolute necessity considering the number of banks and number of checks involved. Without a nationwide system of electronic funds transfer it would be inconceivable for a depositary bank to directly present every check to the multiplicity of payors. The same principle does not by any means hold true for the less than 1% of all checks that are returned. This relatively small number of checks is potentially suitable for some sort of direct contact between the returning payor and the depositary, particularly where the depositary bank can be readily and quickly identified by means of the new ANSI standard.

In order to significantly reduce the time needed for the return trip, the cumbersome chain the check followed on its forward journey must somehow be avoided. There are two possible ways of doing this. One is for the payor to send the returned item directly back to the depositary and to receive a credit for it from the depositary. This method is suggested by optional UCC section 4-212(2). That section, which allows the payor to timely return an unpaid item directly to the depositary and obtain reimbursement by sending a draft on the depositary, could easily be adopted as a required method of dealing with returned items. Strict timetables for the return would be needed and the return would have to follow some expedited routing; ordinary U.S. mail would not be fast enough to be helpful. With the mandatory adoption of the ANSI depositary bank endorsement, there is every reason to believe that direct returns are technologically feasible.

An alternative to direct return of checks is to allow them to be returned in the current manner, but to require the payor to directly notify the depositary when it determined to return a check. This direct notification (presently found in S. 573) could be accomplished by wire or through the Federal Reserve System. The ANSI endorsement standard would serve to facilitate this process as well. Again, the notification would have to be by a rapid means, not by ordinary U.S. mail. Direct notification would serve the same function as direct return: upon receiving a notice that a check was being returned unpaid, the depositary bank could protect itself by refusing to release the funds. Credits previously given would be revoked when the check was actually returned, as they are now.

S. 573

S. 573 is boldly innovative in its requirement of direct notification within 24 hours after a payor bank has determined not to pay a check. I would urge your consideration of the following points in connection with this bill:

(1) First and foremost, S. 573 only requires payors to give direct notification: it does not take the concomitant step of requiring depositary banks to release funds more quickly than they now do. While competition and public opinion might have the desired effect, a more comprehensive regulatory scheme would assure the desired result.

(2) As written, the bill requires the ANSI endorsement standard and direct notification within 24 hours. It does not specify the mode of notification, nor how quickly it must arrive. Since complex technical matters are involved in this problem, the maximum degree of flexibility and innovation should be encouraged. Either direct notification or direct return would work to

greatly reduce the length of the return trip of a check and thus make possible accelerated granting of withdrawal rights by the depositary bank. The choice of which method to utilize should probably be left to the banking industry and its regulators. Indeed, both methods might be utilized side by side, with payor banks being allowed to choose between them as circumstances dictate. One method might prove to be more efficient and desirable for certain categories of checks or might, over time, be found to be most useful generally. Having mandated the broad requirements, the precise methodology should be left to the Board of Governors of the Federal Reserve System. In addition, because banks will have to revise their computer programs to meet the new requirements, some reasonable phase-in period should be allowed.

(3) S. 573 mandates direct notification for checks of $250 or more. Studies suggest that a large proportion of all checks are written for amounts of $100 or less. Thus, the direct notification provision of S. 573 would have no effect on many checks. While some floor should certainly be established in order to avoid excessive costs, $250 is arguably too high. Setting the floor at $100 would involve a greater volume of checks but would also be more useful to depositors. At the same time, by excluding checks under $100, the costs of direct notification may be avoided where they are not truly justified. The Federal Reserve Board of Governors should be directed to undertake a limited further study and set the floor appropriately.

Cost And Loss To Banks

Either a direct return or direct notification requirement will impose new costs on the check collection system. Direct return, however, might very well trade off new costs for a reduction in some present ones, as the repetitive manual handling of returned items is reduced. Whatever increased costs there are, however, should be passed along to those who caused them: the depositors of returned checks, and ultimately, the drawers. It is not uncommon for banks to charge a returned check fee to customers who deposit checks that are returned unpaid. Moreover, many payees impose a similar handling charge on the drawers of a returned check. The right of the depositary bank to collect a charge from its depositor and of the depositor to collect from the drawer could easily be codified. Rather than requiring the depositary bank to prove the amount of damages, a standard charge figure should be developed and applied. This amount could be appropriately split between the involved payor and depositary banks to reflect their costs. The payee could conveniently seek reimbursement for the charge when he sought to collect the amount of the returned check.

In the event that the new credit release requirements were shorter in a particular instance than the actual expedited round trip, the depositary bank might be exposed to some risk of loss. To minimize this risk, the idea of an insurance fund should be considered. The fund could be established by direct assessment of a small amount on every check processed, thus spreading the costs among all banks in proportion to the number of checks handled. Alternatively, the returned-check fee collected from the depositor could include a charge that would go towards such a fund. A small charge collected on only a portion of all returned checks would generate a substantial fund to compensate banks who indeed suffered losses. Another way of reducing the potential for losses would be to exclude checks for over a certain amount from the operation of the new DFA hold periods.

Float Loss

If depositary banks are required to give up their current, often lengthy DFA holds, they will suffer a definite loss of interest income on the associated float. Presumably some of that lost income will accrue to the benefit of depositors who will have significantly earlier use of their funds. It must be remembered that the banking industry has no claim of right to this interest income -- it is merely incidental to the protective policy of DFA holds. As long as banks are amply protected against loss (as they would be under this proposal), they must not be heard to complain about this loss of income. Bank regulators must be alert to attempts to recoup these lost interest revenues through higher fees or lower interest to bank customers.

RECOMMENDATIONS

A statute addressing the significant issue of Delayed Funds Availability should be founded on the principle that it is the public policy of this nation that bank customers receive the use of their deposited funds as quickly as possible, consistent with the protection of banks from unreasonable risk of loss. To that end, the statute should direct the Board of Governors of the Federal Reserve System to issue regulations on the subject. Those regulations would do the following:

(1) Require the use of an endorsement standard that would facilitate either direct notification or direct return;

(2) Require the use of either direct notification or direct return of checks for more than a certain amount, (e.g., $100), in an expedited manner;

(3) Require the release of deposited funds on a timetable consistent with the now accelerated round-trip of returned checks.

The details of the regulations, such as the method to use, the exact credit release timetable, and so on, should be left in the sound discretion of the expert regulators who are closest to the problem. In devising these regulations, the Board of Governors of the Federal Reserve System would recognize that what is required is enough time for a check to reach the payor, plus one day for it to determine whether to pay and perhaps one additional day for the direct return or notification. Since about 98% of all checks would be received by the payor banks within three days after their initial deposit, a maximum of four to six days' funds hold would probably suffice for the worst case; a shorter time would apply to many checks. The Federal Reserve System could be charged with developing more precise schedules for checks deposited in and drawn on various locations and the credit release schedules could be modified from time to time as experience required.

Special treatment and greater delay could be allowed for certain categories of checks that might cause special problems. These would include deposits to new accounts by unknown depositors, deposits to accounts that had previously suffered bad return experience, or deposits of checks of a suspicious or high-risk nature. In addition, savings banks, which forward items for collection through correspondents, would be allowed appropriate extra time.

One additional aspect of the new credit release schedule should be particularly rapid crediting of most government issued checks, bank checks and certified checks. These items are highly unlikely to be returned due to non-sufficient funds or stopped payment. Any problem with these checks is likely to be due to theft and forgery. However, even a four week (or longer) DFA hold will not protect the depositary bank from these risks, because even after final payment the payor bank is entitled to recover on the forged endorsement in an action for breach of the warranty of good title. Since the discovery of the forgery and the warranty action could conceivably occur months after the check was deposited, the typical DFA hold offers no protection whatsoever against this problem. Therefore, credit should be allowed as of right on these checks as soon as the depositary has itself received provisional credit. In most cases, one day should suffice.

CONCLUSION

The 99% of depositors who deposit 'good' checks deserve to have the use of those funds as early as possible without undue risk to their banks. In the absence of widespread use of electronic funds transfer, this can only be accomplished by mandating faster credit release than is currently allowed. At the same time, banks must be protected from the risk of skyrocketing loss on returned checks. The proposal given here will serve to protect banks, enhance availability of funds to the bulk of depositors and shift the cost of doing so to those few depositors and drawers who cause the problem. It is feasible from a technological and practical standpoint. All that is required is the will of Congress to go forward.

STATE OF NEW YORK

6435

1983-1984 Regular Sessions

IN SENATE

May 2, 1983

Introduced by Sens. ROLISON, FARLEY, FLYNN, KEHOE, MARINO, BERNSTEIN, GALIBER, LEICHTER -- read twice and ordered printed, and when printed to be committed to the Committee on Banks

AN ACT to amend the banking law, in relation to the right to draw against certain deposits

The People of the State of New York, represented in Senate and Assembly, do enact as follows:

Section 1. The banking law is amended by adding a new section fourteen-d to read as follows:

§ 14-d. Power of the banking board to prescribe a reasonable period of time permitting the drawing on items received for deposit in a customer's account. 1. It is the public policy of this state to provide all retail banking customers with the ability to draw against items deposited for collection with any banking institution located in this state within a reasonable period of time.

2. The banking board shall promulgate regulations, which may be amended from time to time, establishing a reasonable period of time within which a banking institution must permit a retail banking customer to draw, as of right, on an item which has been received for deposit in the customer's account.

3. The superintendent is authorized to gather from banking institutions such information as may be required by the banking board for the promulgation of the regulations required by this section.

4. (a) Except as otherwise provided in paragraph (b) of this subdivision, a provision in any agreement between a banking institution and its retail banking customer which provides for a period of time longer than the period prescribed under regulations promulgated pursuant to this section is unreasonable for purposes of article four of the uniform commercial code and, in lieu thereof, the maximum period of time permitted in the regulation shall be deemed controlling. For all other purposes the provisions of this section shall not be deemed or construed to alter or impair any right or obligation under the uniform commercial code.

(b) This section does not prohibit a banking institution and a retail banking customer from agreeing in writing to a greater period of time than that otherwise prescribed by regulation pursuant to this section for the drawing against items because of special circumstances, provided that, such agreement is not contained in a pre-printed form and is not a usual, regular business practice of the institution.

5. Such regulations shall require every banking institution to notify each of its retail banking customers, in writing, of the applicable time limitations on the right to draw on items received for deposit in the customer's account and to keep posted in a conspicuous place at each branch, a notice substantially setting forth the generally applicable time limitations of the banking institution's customers' rights to draw on items deposited to their accounts.

6. The banking board is empowered, upon a determination that the uniform application of a regulation adopted pursuant to this section would result in unsafe or unsound banking practices, to issue such further regulation or order with respect thereto as it deems appropriate.

7. In this section "banking institution" has the same meaning ascribed to it by section nine-f of this chapter and "item" has the same meaning ascribed to it by the uniform commercial code.

§ 2. This act shall take effect immediately.

EXPLANATION--Matter in *italics* (underscored) is new; matter in brackets [ ] is old law to be omitted.

LBD10326-02-3

Senator HAWKINS. Thank you, Professor. Your 5 minutes has expired. Your statement will be placed in the record.

Mr. Essary.

STATEMENT OF GAYLE ESSARY, PEOPLE INC., FLUSHING, N.Y.

Mr. ESSARY. Madam Chairman, Senator Dodd, I want to thank you for the opportunity to speak on this subject here. I have submitted testimony, of course, and for the most part it will stand for itself; therefore it might be possible to address some of the things which have come before the body this morning, and even a question or two to which I don't know the answer, and to which perhaps someone could enlighten us.

First, I must say in listening to the Vice Chairman of the Federal Reserve Board this morning, he sounded just like the branch manager of my bank did when I first approached her on this subject.

As a matter of fact, I happen to be the sort of person who gets angry, and it passes. In fact, I don't think I've been angry in 6 or 7 months concerning this subject, however, in listening to his testimony this morning, I want to confess that that anger renewed itself because he sounded like a banker, and because I thought that he worked for the Federal Government and the taxpayers, and because I thought that his job was to regulate banks and not to make excuses for them. I'm afraid that we may be acting too kind—although it doesn't sound like Senator D'Amato, for example, has been too kind. I don't think this is the time for kindness. The time is ripe for action.

I would question a number of policies. One of the things that is very interesting is that the Senators on this committee have been leaning over backward, and instead of demanding that the Federal Reserve provide the solutions, have been themselves fishing for solutions, coming up with this idea and that concept and even the suggestions incorporated in the excellent testimony of Professor Wechsler. I'm sure that Professor Wechsler has been available to the Federal Reserve. He is not a mystery person. This information he's provided to you represents details of how to accomplish this on a technical level. It has been available to the Federal Government before and to those bodies who have been charged to regulate this matter.

Rather than his testimony before the Senate, it would have been far more appropriate for him to have been interviewed by the Federal Reserve as a consultant in order to get this action started.

I would go even further to the heart of the matter and would seek the answer to the question which I think somehow has escaped us all. I must admit it had escaped even me until I had thought about it coming down here.

We seem to be speaking as if it is a fait accompli that the system is that the banks receive provisional funds from the Federal Reserve and that they then use their customers' money to gain interest. Well, I don't think that's quite exactly what's happening at all.

What is actually happening is that the Federal Reserve is advancing funds to the banks and the banks are using Federal Reserve money to draw interest. The check has been presented to the bank and then to the Federal Reserve and then the Federal Reserve has presented that through its system to the paying bank, and final settlement has not yet occurred. Final settlement has not occurred to the point that the Federal Reserve has received the money from the paying bank. I haven't researched it, but my understanding is that only the Congress has the right to appropriate funds, and I would be interested in seeing the authorization to the Federal Reserve to in effect advance taxpayer money to the banks for this purpose. This is the key question.

If the Fed is advancing provisional funds, then it is advancing those funds without having received it from anywhere and they are waiting for the final settlement. I see nothing wrong, whatsoever, with this being the practice as long as the banks come to the Congress and ask for this authorization. Meanwhile, the Uniform Commercial Code clearly indicates that this money that is advanced from the Federal Reserve to the bank is supposed to be passed directly on to the customer in the form of provisional funds.

The Federal Reserve, in essence, is saying, "We trust the bank to repay." The bank, in turn, is obligated to trust their customers, under certain circumstances, to make that repayment, if it becomes necessary.

I hear testimony about it costing so much. I just saw in the newspaper this morning on the same page that it speaks to the issue of whether or not the Senate is going to give money back to the International Monetary Fund in order to repay the banks their interest, that there is a new system that gives instantaneous computerized mail delivery up to five pages for only one dollar.

You could notify banks of quite a number of returned checks on a same-day basis for this $1, using MCI.

I also question this whole issue of the 1-percent figure for bad checks. I haven't heard anyone explain what that term means. Does "bad checks" mean checks in which there are insufficient funds to pay or does that 1 percent also lump in the checks that are returned because of uncollected funds? If it does, then it's not a bad check; it's a bad bank.

Finally, if this Congress could look into whether or not the Federal Reserve is in fact preempting congressional authority granted by the Constitution, that would probably speak to the heart of this matter, and resolve it.

Also, if the law simply stated that any bank receiving provisional funds should also under certain circumstances offer provisional funds to their customers, that would likewise resolve the problem.

We addressed Citibank on this question, and in the addendum to my testimony, in item No. 2—and I'll quote the statement that we presented to the Citibank asking that they make this policy available to their customers: "If you have had an account in good standing for longer than (blank) months"—and our suggestion was that prudent banks be allowed to fill in that blank—"and your deposit check from a bank known to this bank is less than (blank) dollars"—again giving the bank the authorization to make its own policy in this regard—"you will be given access to those funds no later than 24 hours from your time of deposit."

The response from the Citibank in writing is that "Citibank will introduce in the near future a service similar to the one suggested.

The service will allow accounts which have had less than one overdraft for each 6 months the account has been opened—maximum 2 years—to use delayed funds in amounts which increase from $25 for the first 6 months the account is open, to $250 during the next 6 months, $500 in the next 6 months, $1,000 in the next 6 months and finally $2,500 for accounts opened more than 2 years."

As long as they don't define overdrafts as checks paid or checks presented against uncollected funds, then we certainly have no objection to this. But I haven't seen that happen. Citibank has only said that they're going to institute that, but I've seen no action and I've heard nothing further about it.

Senator HAWKINS. What was the date of that?

Mr. ESSARY. That was June 23, 1983.

Senator HAWKINS. Thank you so much. We have some questions for you and I appreciate your testimony.

[The complete statement follows:]

GAYLE ESSARY
President

UNITING
THE WORLD
OF COMMERCE

September 28, 1983

TESTIMONY GIVEN BY GAYLE ESSARY,
REPRESENTING PEOPLE, INC., NEW YORK
STATE BUREAUCRATIC AND INSTITUTIONAL
REFORM ORGANIZATION;

TO THE SUBCOMMITTEE ON CONSUMER AFFAIRS, COMMITTEE
ON BANKING, HOUSING, AND URBAN AFFAIRS, SEPT. 28,
1983, AT 9:30 A.M., ROOM SD-538 OF THEDIRKSON SENATE
OFFICE BUILDING;

IN SUPPORT OF S.537, THE FAIR DEPOSIT AVAILABILITY ACT:

MADAME CHAIRMAN, SENATOR HAWKINS, my name is Gayle Essary, and I operate a small business known as ESCO General Corporation, a division of which, ESCO Media Group, is the world's largest independent advertising sales organization, supervising some 200 sales people in some 70 sales offices representing publishers of about 50 business and consumer magazines around the world. It is headquartered in Flushing, N.Y., a part of New York City.

On December 20, 1982, in order to have funds in my firm's operating account to pay various overhead bills, I deposited a check which I had written December 9 for this purpose on my firm's account with a New York State money fund into my firm's operating account with Citibank, Branch 187 in Flushing. The check was for

35-73 159th Street, Flushing, N.Y. 11368 / (212) 445-8063

$3400, the original of which I am prepared to make available to this Committee to verify and photocopy.

In a couple of days, I received a Transaction Advice from the Money Fund which showed that the $3,400 check was received and the actual cash had been transferred to Citibank on December 21, ONE DAY LATER. Also, the actual check itself was enclosed, with the endorsements on the reverse showing the money fund's agent, Bank of New York, had paid Citibank on December 21.

With this knowledge that the check had IN FACT cleared, I wrote a series of small checks to pay bills and sent them out. When I started receiving notices from the bank that they were returning these checks unpaid marked "Funds deposited but not yet collected," eight days later, I gathered up my evidence and went to the branch and demanded an explanation. Instead of an apology the bank manager went on the offensive, stating loudly in front of other customers that I had written these checks without funds in the bank to pay them. She refused to acknowledge my cancelled check and refused to refer me to anyone higher. Needless to say the episode escalated into a shouting match, one which I have since discovered is repeated dozens of times daily at banks all over New York because bank customers are frustrated at the treatment they get and feel they have no recourse or appeal.

I decided that I did in fact have recourse, and in the knowledge that banks are subject to laws and that all laws are enforced and made by those who derive their powers from the people, I spent the lunch hour the next day passing out leaflets asking other customers of the branch whether they had experienced similar abuses.

To my surprise, because by and large I have noticed that New Yorkers are rather prone to keep their distance from causes and issues debated on the streets, almost every customer emerging from the branch after having read the leaflet in the routine 15-minute line, stopped by to say something, and over half wanted to tell me his or her own experience. The bank closed my firm's account in response.

Next, the N.Y. Daily News heard about my little personal effort and ran a story. I wasn't quite prepared for the avalanche that followed. Over 100 people wrote and called after having the first contact the newspaper, get the correct department, and ask how to get in touch with me. This was the beginnings of PEOPLE, Inc., a non-profit organization interested in bureaucratic and institutional reform, but with a special interest in banking reform. In the ensuing weeks and months, we were successful in having the issue raised in local, regional, and national media, debated in state and Federal legislative bodies, and because we look upon legislation as the last resort to assist institutions unable or unwilling to govern themselves, we presented the issue directly to the primary offending institution itself.

On April 19, a group from PEOPLE, Inc., attended the shareholders meeting of Citicorp by proxy, and thus armed with floor privileges, succeeded in raising the issue directly with Walter Wriston, chairman of Citicorp. Mr. Wriston invited our group to meet with Citibank officials, we accepted, and on May 11 this meeting took place.

Present at the meeting was myself, my wife, Linda Essary, who was present to take comprehensive notes, and Mike Weber, staff research assistant to State Senator Franz Leichter, who has sponsored the most complete banking reform legislation in the New York State Senate. Present for Citicorp was Pamela Flaherty, vice president, and Vinnie Woldanski and Alan Diener, regional operations managers for Citibank's branch system.

At the meeting, PEOPLE formally presented the "Bank Customer's Check Clearance Bill of Rights" which Chairman Wriston had agreed the bank would discuss and respond to at the Annual Meeting. This 10-point program, written from the perspective of a bank posting this as a notice to its customers, is reproduced on the next page for your reference. Because we wanted to take full advantage of our audience, we simultaneously raised 14 other banking reform concepts which had been developed in the course of our research and consideration of the problems members of the public told us they encounter most frequently in dealing with their banks. These additional consumer and bank customer issues are listed briefly in the "TRANSACTIONS" newsletter issued following the meeting on May 19. This is also reproduced here for your reference, and I will be glad to discuss in more detail the points raised in this document, as we discussed with Citibank officials in our meeting.

We were cordially received and the meeting progressed in a friendly and open manner. Ms. Flaherty promised to reply in writing, and although we have yet to hear a response to the additional 14 issues raised, she did mark my birthday June 23 with the promised response on the 10-point Bill of Rights. Again, for your convenience, this response, and my return correspondence, are reproduced for yourr convenience and reference.

While the exchange was cordial enough, we have seen no real improvement in the length of time Citibank holds checks, but then my personal experience is limited because my personal account has been moved to Chemical Bank which is the most competitive major bank in New York City in clearing checks. I was also impressed when a branch official, when hitting a technical snag in opening our personal account because a necessary form had not yet been received following a communications snafu between banks took it upon herself to cut through red tape in favor of the customer's right not to be inconvenienced because the bank's system had failed. I never found a Citibank employee who would make a "humanistic" decision which would be contrary to established and unassailable bank policy.

As a point of fact and information, the more customer-oriented practices of Chemical, and the faster clearing times developed in direct competition with Citibank, as well as theopen defiance of Citibank by other banking institutions (I refer, for example to the May 9 ad in the New York Times by Independence Savings Bank which challenged Citibank's decision to limit human contact at some branches to individuals with $5,000 or morein their accounts, a policy reversed May 16 as one of the more positive direct improvements in Citibank's policies promised by Ms. Flaherty at our May 11 meeting), are among the results of the public awareness campaign which was begun in the traditional American way. One person, taking advantage of the guarantees of free speech and a free press, in a manner as primitive and limited as passing out leaflets on a sidewalk for one hour can gain national attention for the issues being raised if the cause is just and right, and if the problem is shared by enough people.

I feel compelled to add that this renews faith in our basic institutions, as long as those institutions maintain as their foundation and cornerstone the freedom to each individual to speak his or her mind. It is upon this experience and in this faith that I feel that no institution or bureaucracy, not this Senate, not the Presidency, and not banking or corporate America is beyond the scope, the review, and the change initiated at the INDIVIDUAL level, from which all powers must be derived.

Therefore, while I am representative of a group, and while I represent, indirectly, many groups -- customers, consumers, small businessmen, New Yorkers, families, etc., I feel that I need no credentials beyond, "Citizen, United States of America," to boldly suggest and expect that my elected representatives and institutions which I and my fellow "Citizens, United States of America," have given certain powers, will use those powers to make reforms where I and my fellow citizens are seeking refuge from abuse by those who have exercised these powers in excess of that which I and my fellow citizens intended, or at the least, now intend.

I feel this little exercise in basic Civics is necessary because banking practices as addressed in S.537 can't be isolated from other banking practices. I would suggest that bank customers are charged by their banks in the form of almost a Billion Dollars of interest every year so that the banks can use this money to capitalize, however meagerly, their "imprudent" banking policies relative to foreign lending. Then, that is not enough, banks charge fees to us when we try to use the money we have put into our accounts before the banks feel like they want to give us access to it. Often, just to milk our accounts for every penny they can get, they will then run the same check through a second time the next day although knowing beyond a shadow of a doubt that they don't plan the next day either to give us access to those funds. This gets them another $8 or $15 "fee" for all this hard work and extra bookkeeping.

We have raised the issue, and we will raise it again here, that it is illegal, improper, and unprecedented for banks to simply "deduct" fees from my account or your account. I know of no Uniform Commercial Code which provides for this practice. I know of no law that allows it. I know of no agreement between the bank and me which allows it. I don't think the telephone company can go into your account and take their charges. I don't think even the post office can do this. No other institution is granted this privilege. Why can banks do it? Because they have done it for so long without challenge that it is just accepted and not questioned. So, I'm now challenging and questioning, and hope the Senate will help me get some answers and legal authority. If this can't be produced, I'd like for the banks to be asked just to give it all back. There is nothing wrong with my bank charging me for a service and rendering me a bill. I can pay it or refuse to pay it, and they can go to court and prove I owe it. They have adequate remedies under the law. But I don't believe they can just take my money out of my account which I have authorized them to hold for safekeeping. It's like employing the burglars to watch your house.

Then after all these charges, the banks come to the Senate and ask you to charge us through taxes again to pay off foreign loans because they just can't seem to get enough money from our accounts.

That's why I say this can't be isolated. It's just another charge going to the same place. The banks have used as an excuse that their bad check ratio would mean they would be employing imprudent banking practices to grant access to funds sooner than they are reasonably sure the funds have cleared. Yet they can employ imprudent banking practices of a monumental nature because they feel if the stakes are big enough -- the very survival of the banking system itself -- you won't let them lose this much money. Count pennies, but be free and easy with millions.

So, now we have been charged and billed and taxed and then charged and billed and taxed double and triple.

Again, I feel we have to take a more basic view, something I feel it is a fair criticism of another institution, the U.S. Senate, for example, is moving further and further away from. You have Senate Bill Number this and that, and in dealing with these details of public policy, have little opportunity to deal with the broader scope. I feel it would be a good exercise for the Senate each session to pass a resolution which results from a careful study and attempted editing of the Constitution and our basic documents of democracy. While not binding, this would require such a broader view of your deliberations, and it could result in concepts about policies and laws which have deviated.

For example, the Senate, our governments and our executive departments, and as well our public utilities and transportation infrastructures, our industrial policies, our banking institutions, commerce itself, all of these things and each of these things were formed and allowed to exist within our laws because they were deemed to be benefits for the citizens and the public.

If and when they cease to benefit the public, shouldn't they therefore be abolished? And if there are rules, regulations, practices, procedures, or policies instituted by these "institutions," shouldn't these be reformed or abolished?

The problem with banking, in the sense that it can remain "free enterprise," not subject to the legislative review such as it is undergoing in these hearings, is that banking is pervasive in our society. You can not operate or do business without it. Yet, it has evolved so that it controls the public instead of the other way around. This process must be reversed by the institution itself, or I, and my fellow Citizens, with your help, must reverse the process in the absence of self-reversal. We just can not tolerate our institutions infringing on our freedoms -- personal or commercial or in any other way.

This "quasi" government bureaucracy, like all institutions, has a soul, a will, and a life of its own. It has, in its odd Darwinian evolution, developed tenacles and radar, and all kinds of devices to warn it and protect it from intrusions against its intent to fulfill its programming -- gobble up as much of the money it can. It is surrounded by people who train other people to be managers and assistant managers and branch managers whose sole purpose is to protect their institution from assault and to go by the book in all matters and in all things. Appealing to the basest of human instincts, it puts people in positions of power, and these people exercise this power no matter how much or how greatly this exercise of power abuses customers and the public. Once it is found that you can not do without an institution or a service, free enterprise, at least as it applies to a customer's market, goes by the boards because it now becomes a "seller's" market, meaning the public no longer has a say in the "free and open" market. This institution can be courteous and nice and sugar and spice as long as it needs something from us -- our money which we have somehow found a way to transfer without the bank's help, or our public assent through the laws which regulate its activities, but that can turn to ice, ice which filters through every layer of management and can be felt in every bank line and at every window, as soon as it feels powerful enough that it no longer needs. Then it controls.

Institutions, because they can bring out the basest human indecencies whenever left unregulated and unwatched, will use every trick to get and keep an upperhand. Their people -- in teller lines, in meetings, and in Senate hearings -- will say whatever is necessary to protect their position and enhance it. They will withhold information of one sort on feeble excuses, and load you with information of another. Do you ever see a balanced, credible, truthful, factual presentation by anyone representing this institution? Does anyone ever come to these hearings and say it is a mistake to do this or that, because it's not in their customer's interests. Obviously, since you represent the public, and you are trying to make public policy on behalf of people, your credentials are that you have the confidance through these people's votes to effect these reforms. Then why would the representatives of these institutions, if they really do have the public's interests in mind, take any position which is different than your own? Or mine?

If they make statements which they know to be untrue, which I know to be untrue, and you know to be untrue, how can they be believed at all? This is the absurdity which is associated with this kind of institution -- the unwillingness of people representing institutions such as banking to just straightforwardly come to grips with their own relationships to their primary existance as a human being first and a banker or institutional representative second, and advance reforms and solutions to public problems based on their own allegiance to humankind. Why shouldn't we all -- all of us humans, that is, join together to make our institutions serve us rather than the other way around? Unless we address these primary and basic questions, we are always going to be coming to hearings like this hearing people say what they are supposed to say instead of what they really think.

If being a banker or an institutional representative means foregoing ones allegiance to humanity and human needs, and instead expressing only those thoughts that have been approved up and down the line without deviation, I feel such individuals should be warned that their institutions to which they are being so loyal probably views them as useless humans as well, and perhaps the day will come when their institution will simply replace them with robots and computers. After all, computers can testify at Senate hearings, using preapproved, undeviating language, and robots have already proven they can dispense money.

One of the things which institutions have done to protect themselves is to go to public regulators, like the Senate, and convince these regulators that more specific regulators should be appointed to oversee their activities and protect the public. In setting these more specific regulatory bodies up, and in the "institutionalization" of this practice as well, state by state, and industry by industry, we have a system of what appears to be regulation of our institutions.

What I mean is that regulatory bodies are made up of people from the groups they regulate, or people with the same interests.

Bodies such as the Federal Reserve come to mind. But it's no different than Boards of Insurance made up of insurance people regulating insurance policies and practices. To work properly, as they were intended, these existing regulatory institutions must be made into "sub-boards" and sub-agencies, or abolished, and the real power must be given back to individuals who have no credentials except that they are citizens.

In New York State for example, the state assembly passed what even the venerable New York Times was hood-winked in to reporting was a "consumer" bill, so defined in impeccable Newspeak. It was a bill which is to "regulate" check clearing by assigning this power to the State Banking Board, made up of course by people who were, will be, or have been bankers. It's like hiring an arsonist to run the Fire Department.

If the State Banking Board sets the maximum clearance delay at five days, this will be five days longer than it should be if the consumer were truly served, and while this may be an improvement on what is, it is the institutionalization of what should have never been, and only sets a precedent which gives bankers a friendly committee to come back to in 1995 and ask for the right to hold onto our money for six months before giving us access to it, or whatever they feel they can ease into by that time with the least public outcry.

In the perpetuation of this kind of doctrine of public regulation, the United States Senate is aiding and abetting whatever public policies and abuses are thus implemented.

Whenever the institutions, such as banking, are immune to public regulation, in ways such as this, we give rise to collusion, direct and indirect, spoken and unspoken. We have laws against price-fixing. However, policy-fixing and practice-fixing results in financial abuses which are just as significant, and these go on unregulated and unchecked. Why does it take a public campaign such as we had in New York before other banks are willing to step out of the "old boy" line and become competitive in policies as well as in prices?

The summarization of this discourse is that banks will not give customers access to their money unless they are made to do so, either by popular or regulatory demand. And they will give access only at whatever time they feel they can with the least pressure to do more.

Regulatory demand will not occur until bodies such as the Senate, directly linked to the public will, require it. And the U.S. Senate will not be successful in requiring it until it has undergone its own self-analsysis of its purpose and how it has now and in the future will delegate powers which it has been given by the electorate to which it is responsible. If you are delegating powers given to you for safekeeping, and these powers are not safe in the hands you have entrusted them to, you have an obligation to me and my fellow Citizens to get those powers back and be more careful with them in the future.

All of which leads us to a simple, direct solution to the question of check-clearance. So simple, I am interested in the programmed response of the institutional representatives who must choose between implementing the solution on its merits and pure logic, or of fighting it because that is the program here.

The Federal Reserve gives "provisional funds" within 24 hours to all of its customers, a practice it deems prudent, because it has the power to ask for those funds to be returned if the check fails to clear, and it trusts its customers to do so.

The simple solution: our 10-point Bill of Rights is simply the implementation for an extension of the same doctrine to the customers of the banks, in turn.

Banks should similarly grant "provisional funds" to their customers in the same manner. In the implementation, prudent bankers should employ some of the devices outlined in our Bill of Rights, many of which are employed already by such institutions as the Bank of America in the policies it outlined in your prior hearings, to insure that these provisional funds are withheld in questionable situations and instances.

The Uniform Commercial Code already grants banks the power to require that such "provisional funds" be returned to a bank when a check fails to clear. This concept and doctrine was clearly the intention of the lawmakers. In most instances, such depositors will already have on deposit sufficient funds. In other instances, the depositor in such a situation will be given his or her rightful opportunity -- now denied in any timely fashion -- to go to the maker of such a check and obtain cash or certified funds to satisfy the bank's demand. And in almost all instances where the bank has pre-qualified the customer in the ways we have suggested in our Bill of Rights, the customer will be equally as intent on returning the funds so as to not damage the financial standings now enjoyed.

Of course, any pre-qualification of a customer should never include, nor be allowed to include, any records where checks have been returned due to uncollected funds. That doesn't reflect on the integrity of the customer.

It instead is a reflection on the integrity of his banker.

****

REFERENCE: ABA Bank Collection Code, Fed. Res. Regulations & Fed. Res. operating letters, and U.C.C. Subsection (1) 4-212:

"If a collecting bank has made provisions settlement with its customer and the bank fails to receive a settlement for the item, the bank may revoke the settlement given by it, charge back the amount of any credit given for the item to its customer's account, or obtain a refund from its customer whether or not it is able to return the check...."

People, inc.
35-73 159th Street, Flushing, New York 11358 (212) 445-8063

May 19, 1983
TRANSACTIONS

EXPANDED BANK REFORM ISSUES DISCUSSED WITH CITIBANK

Gayle Essary, representing People, Inc., and Michael Weber, representing State Senator Franz Leichter (D-Man.), met Wednesday, May 11, with Pamela Flaherty, Vice President of Citibank, and Vincent Woldanski and Alan Diener, branch district managers for Citibank. Essary and Weber were accorded a very courteous reception, and Flaherty expressed Citibank's genuine feeling that "we need to respond to customer concerns." Flaherty said it is obvious that Citibank's level of service is not what the bank wants it to be. The following represents the banking reforms which Flaherty said she would study and then provide People with Citibank's formal response:

1. Bank Customer's Check Clearance Bill of Rights.
2. Moratorium on neighborhood branch closings until competing bank is allowed to bid on proposed location of closing.
3. System of accepting bank history at prior bank for purposes of offering bank services and credit reporting.
4. No charges or fees not agreed to in advance, and immediate end to questionable legal practice of deducting bank fees without customer written authorization.
5. Elimination of broad collateral clauses in loan instruments.
6. Availability of all information in bank's files on customer.
7. Establishment of pro-rata system of loan capital in ratio which gives fair opportunity to small and medium depositors.
8. Elimination of savings account requirement as prerequisite for check clearance privileges.
9. Elimination of size of account as prerequisite to teller access.
10. Maximum waiting times no more than 15-minutes, and sufficient staff to guarantee this as a criterion.
11. Option to all customers for teller service or electronic service.
12. Increased customer access to branch management.
13. Extra week's training for all tellers in human relations and problem-solving techniques.
14. More pay for tellers -- front line of customer contact.

EQUAL OPPORTUNITY REFORM GROUP

We are making plans now to give equal opportunity to all banking institutions in New York City to respond to these reforms, although as we informed Citibank, we expect Citibank's response to influence the remainder of the financial community.

NOISEMAKING

The Susskind show is scheduled one of the next two Sunday evenings. The Time Magazine article appeared this past week, and seems to have been generally helpful. Sen. Leichter has recently issued another report on "bank gouging," etc., which received phenomenal treatment this past week.

DUES?

Several of you sent in your dues of $15 (and more) this past week, and this is certainly appreciated. Please let us know if you want to continue to be informed on this issue. We're at the point where we need a letter back from you so we can cut expenses if you've lost interest.

People, inc.
35-73 159th Street, Flushing, New York 11358 (212) 445-8063

BANK CUSTOMER'S BILL OF RIGHTS

1. If you have a cashier's check, certified check, money order, or government check and acceptable identification, your check will be treated as cash.

2. If you have had an account in good standing for longer than ___ months and your deposited check from a bank known to this bank is less than $__________, you will be given access to those funds no later than 24-hours from your time of deposit.

3. If you do not meet the requirements above, and we place a hold on your funds, we will notify you in writing at the time of your deposit as to the precise date you can receive cash.

4. Under no circumstances will we withhold availability of any funds for which we have received final settlement.

5. If at the time you have received cash for your deposits and final settlement has not occurred, you will receive notice as to your potential liability in the event the bank must require you to cover funds which are subsequently withdrawn.

6. If this bank uses provisional funds from the Federal Reserve to earn interest on your deposits which are being withheld, this bank will pay you interest on those deposits.

7. If this bank is notified of a dishonored check which you have deposited to your account, or if this bank must decline to pay on checks you have written because of unavailable funds in your account, you may elect to pay the bank a fee for special notification so that you may have the option as to redepositing or covering availability shortages in your account before the bank takes any action which might affect your account's status.

8. If you have a check written on an account on deposit in this bank, and you have acceptable identification, you may cash that check at this bank whether or not you are a customer.

9. This bank's officers have certified that its policies beyond that required by law are its own, and that the bank's officers have not set policies in concert with the officers of any other financial institution.

10. If there are other rules and regulations concerning access to your funds, these shall be added to this document, and this bank shall display all of its rules and regulations on this subject in a highly visible location in each bank. If you have a complaint about this bank's policies or actions toward you, this bank will make available to you forms for complaint, along with pre-addressed mailing envelopes to all public regulatory bodies to which this bank is responsible.

(THIS BILL OF RIGHTS TO BE ADOPTED BY THE BANK, PUT INTO EFFECT, AND CIRCULATED TO THE BANK'S CUSTOMERS)

SATURDAY, APRIL 16, 1983

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Citibank Limiting the Use of Tellers

By PHILIP SHENON

At the Citibank office at 72d Street and Broadway, people with less than $5,000 in their bank accounts don't have to complain about waiting in line to see a teller — they are not allowed in that line anymore.

A rule that took effect last month requires those customers to use the branch's electronic banking machines for all routine bank transactions, such as depositing money or checking an account balance.

The policy, which now applies to 40 Citibank branches, will be expanded to nearly a third of Citibank's 280 branches in the metropolitan area by the end of the year. It is in effect at one other Manhattan location, at First Avenue and 28th Street.

Many of the customers in line for the four machines at the 72d Street branch yesterday said they were outraged by the rule. "The Citi may never sleep, but it yawns a lot because it's bored with us poor people," said Lisa E. White, an administrator at the American Museum of Natural History.

"It's a completely elitist policy," she said. "What the bank is saying is that if you don't have money, you're going to get rotten service."

Citibank, the largest bank in the city and the second largest in the country, said the change was made after market surveys showed its customers rarely needed — or even wanted — contact with a human teller during a common bank transaction.

Teller service will continue to be provided to all depositors for tasks, such as purchasing traveler's checks and cashier's checks, that the machines cannot handle, the bank said.

Susan A. Weeks, a spokesman for the bank, said the machines were popular with customers and more efficient and cheaper than teller service.

"Once people understand that all we are doing is speeding up routine transactions so we can put more emphasis in areas where people really have financial needs, they have responded very well," she said. Citibank is not trying to discourage smaller depositors from using the bank, she said.

She said the bank's recent diversification — it has begun offering brokerage services in a number of branches — had made it important to move many tellers into new jobs.

Sheldon D. Golub, a spokesman for the American Bankers Association, said: "I haven't heard of anyone else doing what Citibank is doing. But I would venture to say that other banks will soon be following the lead. The reason, of course, is that machine transactions cost less than using a teller."

The New York Times / Dith Pran

A sign at the Citibank office at Broadway and 72d Street announcing a restriction in teller service. Some customers have objected to the new policy.

Stickers Sent to Customers

Officials at the Chase Manhattan Bank and the Manufacturers Hanover Trust Company, the second and third largest banks in the city, respectively, said they had no plans to set up a similar system.

Citibank said regular teller service would be available at all branches to customers who maintained average total monthly balances of $5,000 or more in any combination of accounts, including accounts held by members of their immediate family.

"The money can be in any combination of accounts — checking, savings, certificates of deposit, whatever," Miss Weeks said.

The bank knows which customers qualify because under the new plan, the bank periodically sends small stickers to customers who have deposits above the limit. The stickers are then affixed to their electronic-banking cards.

The stickers permit a depositor, Miss Weeks said, to enter the line for tellers in the Citibank branches using the new system. Without the proper sticker, a customer would "be politely told that he would have to leave the line," Miss Weeks said.

The stickers are available only to

Continued on Page 27, Column 1

Citibank Is Limiting Smaller Depositors In Use of Its Tellers

Continued From Page 25

people with deposits in the branches taking part in the new plan. Someone with more than $5,000 in a branch that is not part of the program may not use teller lines in the participating branches.

The 72d Street branch was chosen for early testing of the program because "customers in this neighborhood have shown an overwhelming affinity for the machines," said John J. Blanks, the branch manager. "The machines here are more heavily used than at any other Citibank office."

He said the branch had lost only two customers because of the changeover. "We had a couple of complaints shortly after the service began on March 28," he said. "In the last four or five days, though, there haven't been any complaints at all."

There are now two lines for tellers in the 72d Street branch. One is for so-called Citiexpress customers, who have deposits of at least $5,000. The other is the "Priority Services" line, for people with $25,000 or more in Citibank accounts.

'It's Sort of 1984-ish'

Near those lines is the line for the banking machines. People in the machine lines yesterday said the new system discriminated against poor people. Other customers said they thought the change Orwellian.

"It's sort of 1984-ish," said Frank H. Latson, an airline attendant, as he withdrew $20 from his checking account. "The fact that we are being forced to deal with machines rather than deal with people says a lot about who we are. I'm going to miss seeing a human teller."

Marion Berg, who took her money out of Citibank last year and was standing in line with a friend who still had money in the bank, said: "The name here should be changed to the rich man's bank. I left here when I realized that they didn't want small deposits. I'm not a glutton for punishment."

A timely invitation to every Citibank customer with less than $5,000 in the bank.

Come to Independence Savings Bank. You will find that human qualities are most important here. For one thing, you are free to use either real tellers or our banking machines. And your choice has nothing to do with the size of your account. It has to do with why our customers prefer this bank. They like their Independence.

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NASSAU OFFICES: Hillside Avenue, West of Herricks Road, New Hyde Park • A&S Shopping Center, Manhasset • **SUFFOLK OFFICE:** Walt Whitman Shopping Center, Huntington

DAILY NEWS
NEW YORK'S PICTURE NEWSPAPER®
Tuesday, May 17, 1983

Customers' ire moves Citibank

This 25G customer sees a teller...

By R.B. PLUNKETT JR.
Consumer Affairs Editor

Lori Cardill is angry at Citibank for not allowing her to use a teller at her Broadway and 72d St. branch. And she's angry that all other customers who have less than $5,000 in the bank must do their banking *only* on the four automatic teller machines (ATMs) in the branch lobby.

"It's not the loss of personal service that bothers me," said Cardill, a young actress. "It's that Citibank is taking away my freedom to choose how to do my banking. I don't think that's right."

Now, apparently, neither does Citibank. Although bank officials say the policy of reserving tellers for high-balance customers has been a success, they say are going to change it.

IT ACCOMPLISHED the goal of increasing ATM use, they say, but it also antagonised many low-balance customers who resented being forced into changing their banking habits.

"We made a mistake. We shouldn't have shut off the customers' right to make a choice," said Arthur J. Bassin, Citibank's vice president of marketing and retail business development. At another branch, he said, "We're going to begin this week testing a new policy that allows all customers to use the tellers."

Five weeks ago, New York's largest bank told customers at its 72d St. branch that tellers will serve only "CitiExpress" customers—those with balances of at least $5,000 or more, or "Priority Service" customers with $25,000 balances. The policy is in effect in 40 branches and planned for 53 more.

Now, bank officials say the two-year-old "CitiExpress" concept (separate tellers for customers with $5,000 balances) might also be a mistake. Instead of prohibiting tellers use, Bassin said, the bank will test a program of offering premium incentives (like pots and pans) to promote ATM use.

IN THE MEANTIME, the strict policy will continue at 72d St., but customers who strongly object can be exempted from the rule. "We have already had several elderly customers who said they want to bank the old way and not use the ATMs," said the branch manager, John J. Blanks. "They are being allowed to use any teller."

Citibank officials say the policy is designed to shorten lines, provide better, more personalised service for high-balance customers, encourage people to do all their business with Citibank, and promote the use of ATMs. From that standpoint, the 72d St. experiment has been a success.

The average wait for service at the branch, once known as "The Zoo" by customers and employes, has shrunk from 25 minutes to five. ATM use has doubled to 19,000 transactions a week compared to 3,300 for human tellers. And the branch picked up 217 new accounts during April, Citibank said.

BUT SEVERAL low-balance customers interviewed at the branch recently said that although they have adapted to using ATMs, they feel some resentment against Citibank for forcing them to change their banking habits.

Neville Smythe, an advertising agency executive said, "I'll use the machines, but under this you feel trapped into doing things one way and can't raise any questions."

Other customers said they are staying with Citibank because the annoyances have yet to outweigh the convenience of 24-hour banking centers and 280 branches.

By allowing ATMs to handle routine banking services, Citibank says it can train its tellers for other, more important, duties—namely selling new financial products like insurance and mutual funds.

"We believe we must serve 1.5 million households to survive in the financial services market in New York," Bassin said. "And that means customers large and small. And it means being able to serve customers' needs when their accounts become large and complicated."

Other banking executives aren't convinced. Last week, executives at the Independence Savings Bank and the Apple Bank for Savings (formerly the Harlem Savings Bank) said they are actively seeking business from small Citibank customers.

TOM MONASTER DAILY NEWS

...while they wait for a machine.

CITIBANK

Pamela P. Flaherty
Vice President

June 23, 1983

Mr. Gayle Essary
President
Esco Corporation
35-73 159th Street
Flushing, New York 11358

Dear Mr. Essary:

I want to thank you and your wife for taking the time to meet with me, Vinnie Woldanski and Alan Diener to discuss your concerns about check clearing and other bank service issues. I felt that the meeting was productive and that the concerns you raised were very clear. In the attached paper, we have attempted to answer the issues you raised in your Bill of Rights with regard to check clearing. Some of your suggestions have always been policy at Citibank, and others are under consideration.

The most important issue in all of this is clear communications with our customers. We are currently finalizing a brochure which will explain more clearly to our customers how we handle check availability. Once it is ready for distribution, I will send it to you. I think it will help clear up much of the misunderstanding that has surrounded this very important service which we provide for our customers.

As you pointed out in our conversations, your second list of service issues is rather broad and covered almost every aspect of consumer banking. We appreciate the time you took to compile the list and have found it helpful in reviewing our programs to improve service. I hope you and your members will see improvements in these areas.

Sincerely,

Pamela P. Flaherty

Enclosure

cc: A. Diener
    V. Woldanski

1. If you have a cashier's check, certified check, money order or government check and acceptable identification, your check will be treated as cash.

   Response:

   Citibank has traditionally accepted US Treasury checks and Cashier's checks drawn on Citicorp as cash.

   Since other bank's cashiers and certified checks and government checks as well as money orders can also be returned unpaid, Citibank processes these instruments as it would any other check and makes the funds from these checks available according to our policy.

   If a customer requires immediate use of the funds from one of these checks, we ask the customer to go to a platform representative and request that the check be accepted as cash. If the representative is satisfied that the identification presented by the customer is acceptable and that the check will be honored, the representative may either accept the check for deposit as cash or agree to pay checks which draw against the deposited check on an exception basis. The use of this service for normal transactions is discouraged since Citibank offers both Checks As Cash and Checking Plus which provide this service automatically and without the involvement of branch personnel.

2. If you have had an account in good standing for longer than __ months and your deposited check from a bank known to this bank is less than $__, you will be given access to those funds no later than 24 hours from your time of deposit.

   Response:

   Citibank will introduce, in the near future, a service similar to the one suggested. The service will allow accounts which have had less than one overdraft for each six months the account has been opened (maximum two years) to use delayed funds in amounts which increase from $25 for the first six months the account is open, to $250 during the next six months, $500 in the next six months, $1000 in the next six months and finally $2500 for accounts opened more than two years.

3. If you do not meet the requirement above and we place a hold on your funds, we will notify you in writing at the time of your deposit as to the precise date you can receive cash.

   Response:

   Due to the length of time it would take for notifications on all deposits to be prepared, we estimate that more than 90% of the notifications would be received after the funds became available.

   As an alternative means of communicating the length of delays on deposited checks, Citibank is preparing a pamphlet which describes to customers the length of time it will take before funds from deposited checks will be available. Telephone numbers to be called for explanations and delays not listed in the table will be provided. In addition, the pamphlet will explain to customers why we delay the availability of checks as well as services we offer which permit customers to use delayed funds.

4. Under no circumstances will we withhold availability of any funds for which we have received final settlement.

   Response:

   Under the present system, banks do not receive notification that settlement is final on a specific check.

   Therefore, Citibank pays the customer interest from the day a check is deposited into an interest bearing account and considers a check to have been collected based upon the amount of time we estimate it would normally take for it to be returned to us if for some reason it is considered "Not Good."

   The determinations regarding when we consider a check to be "collected" are based upon extensive surveys we've conducted of deposited checks from every routing code in the country.

   We believe the combination of paying interest from the day of deposit coupled with considering check deposits as collected based upon our actual experience is fair to the customer while enabling us to adequately protect the assets of the bank.

   It should be noted that about 70% of all deposits are considered as collected on the day of deposit and approximately 90% of all deposits are considered as having been collected within 4 business days of the deposit of having been made.

5. If at the time you have received cash for your deposits and final settlement has not occurred, you will receive notice as to your potential liability in the event the bank must require you to cover funds which are subsequently withdrawn.

   Response:

   Citibank does this. After a check which draws against uncollected funds is posted, a notification is prepared. The notification tells the customer the amount of the check which was paid (his risk) and that it was paid against delayed funds.

6. If this bank uses provisional funds from the Federal Reserve to earn interest on your deposits which are being withheld, this bank will pay you interest on those deposits.

   Response:

   Citibank pays interest on all deposits made to interest bearing accounts from the calendar date of deposit. If a deposit is made in a Citicard Banking Center after the bank is closed or on a day that the bank is closed, Citibank will still credit customers with interest beginning with the calendar date of deposit.

   Citibank's policy frequently results in Citibank actually paying interest to its depositors before credit is obtained from the Federal Reserve Bank. We believe this is an excellent benefit to our customers , and possibly unique in the industry.

7. If this bank is notified of a dishonored check which you have deposited to your account, or if this bank must decline to pay on checks you have written because of unavailable funds in your account, you may elect to pay the bank a fee for special notification so that you may have the option as to redepositing or covering availability shortages in your account before the bank takes any action which might affect your account's status.

   Response:

   There are two distinct situations addressed in this situation. The first case addresses a check written on a customer's account, and there are not enough available funds to pay the check. In this situation, banks are constrained by what is known as the "midnight deadline." By law, the midnight deadline defines the maximum amount of time a pyaing bank has to decide whether or not it will honor a check. To do what is suggested would mean that Citibank would have to segregrate the checks, contact everyone who signed up for this service and require each person to come to a Citibank branch with cash or account transfer authorization to cover the check in three or four hours, and if the person cannot be contacted or cannot deposit the funds by the stipulated time, for the check to be returned to the bank which presented it. We really do not know how we could practically deliver this service given the volumes and time restraints involved. It is worth further thought and consideration, however.

   In the second case, a check drawn on another bank which was deposited with Citibank is returned by the other bank. Customers are always notified by mail whenever one of their deposited checks is returned unpaid.

8. If you have a check written on an account on deposit in this bank, and you have acceptable identification, you may cash that check at this bank whether or not you are a customer.

   Response:

   Citibank currently does this if the check is presented at a branch of the bank on which the check is drawn (so that the maker's signature can be verified) and the presenter shows at least two pieces of acceptable identification.

9. This bank's officers have certified that its policies beyond that required by law are its own, and that the bank's officers have not set policies in concern with the officers of any other financial institution.

   Response:

   Citibank sets its policies in accordance with the letter and spirit of the law and without consultation with any of its competitors.

10. If there are other rules and regulations concerning access to your funds, these shall be added to this document and this bank shall display all of its rules and regulations on this subject in a higher visible location in each bank. If you have a complaint about this bank's policies or actions toward you, this bank will make available to you forms for complaint, along with preaddressed mailing envelopes to all public regulatory bodies to which this bank is responsible.

Response:

The rules and regulations concerning access to funds are written in our Customer Handbook. This handbook is given to every account holder at the time the account is published. In addition, we intend to publish a pamphlet which describes our policies on this subject. Therefore, we do not believe it is necessary to post these rules and regulations in our branches.

Customers wishing to file a complaint against Citibank may do so by writing to our Customer Affairs Department, Citibank, N.A., 399 Park Avenue, New York, N.Y. 10043 or by bringing their written complaint into any branch of Citibank and requesting that it be forwarded to Customer Affairs. Every complaint will be thoroughly investigated and responded to individually.

In cases where customers wish to complain directly to public regulatory bodies, our Customer Affairs Department will provide them with the necessary information. If the regulatory agencies wish to provide us with forms for complaint and pre-addressed mailing envelopes, we will make them available to the public.

GAYLE ESSARY
President

ESCO
UNITING THE WORLD OF COMMERCE

June 23, 1983

Ms. Pamela P. Flaherty
Vice President
Citibank
399 Park Avenue
New York, NY 10043

Dear Ms. Flaherty:

Thank you very much for your response to the check-clearing issues raised by PEOPLE, Inc., and by Senator Franz Leichter, whose staff assistant, Mike Weber, was also present at our meeting.

While there are certain aspects of your response where we shall endeavor to influence you to make a greater effort to relate to public and customer needs, we do feel that your over-all response represents a good-faith effort to develop more consumer-conscious services than existed before, and that the response adequately fulfills the dialog your chairman, Walter Wriston, promised PEOPLE at your annual meeting earlier this year.

We especially appreciate your willingness to effect changes in your established policies.

I look forward to receiving your responses on the other, broader issues raised in the near future, and would like for you to know our intention to raise all of these questions with the other banking institutions serving New York citizens.

Certainly we hope to keep the lines of communications open, and plan to contact you again when we have had an opportunity to more thoroughly review and discuss the clarifications and plans incorporated in your response.

Sincere personal regards,

Gayle Essary
Gayle Essary
Chairman, PEOPLE, Inc.

GE/lj

35-73 150th Street, Flushing, N.Y. 11358 / (212) 445-8083

GAYLE ESSARY
President

ESCO
UNITING THE WORLD OF COMMERCE

FOR RELEASE SEPT. 28, 1983
CONTACT: Linda Jacobson
(212) 445-8063

WASHINGTON, D.C. --- The "provisional funds" transferred as cash from the Federal Reserve to banks within 24-hours of each customer's check deposit should be extended similarly as "provisional funds" transferred to the account of the customer by the bank at the same time, said Gayle Essary, spokesman for PEOPLE, Inc., New York state socio-economic reform group, in U.S. Senate testimony today supporting S.537, "The Fair Deposit Availability Act," introduced by U.S. Senator Christopher Dodd (D-Conn.).

Essary, who earlier in the day had appeared on ABC-TV's "Good Morning America," said that banks are extended the funds by the Federal Reserve because "the Fed trusts its customers to return the money if the check fails to clear." He said banks are obligated, under this doctrine, to extend the same courtesy to their customers, and noted that under the provisions of the Uniform Commercial Code, banks have legal remedies available to enforce such a refund.

Essary said he believes this doctrine effectively takes the

35-73 159th Street, Flushing, N.Y. 11358 / (212) 445-8063

"wind out of the sails of the banking institutions using their customers' money in the float, and it leaves them with no excuse to withhold access to our money."

The reform group also asked the Senate to require banks to return fees collected from their customers over the past few years whenever they have refused to honor customer checks due to "uncollected funds." These kind of notices to a customer, Essary said, do not reflect on the integrity of the customer. "Rather," he stated, "such notices reflect on the integrity of the banker who is lying about the funds being uncollected."

He also assailed banks for their practice of deducting charges from customers' accounts. All other institutions, Essary noted --- the post office, the gas company, even the telephone company --- have to bill you for their charges and fees. "Only the bank feels it can just take your money right out of your account." Essary said he does not believe banks can show legal authority for this practice.

PEOPLE also gave the Senate the written exchanges between the organization and Citibank, in which Citibank gave its responses to PEOPLE's 10-point "Bank Customers' Bill of Rights for Check Clearing," implementations of the "provisional funds" availability to customers concept.

Citibank said in its response that it plans soon to make delayed funds available to customers maintaining good accounts, as suggested by PEOPLE, Inc., but did not say when this will be initiated.

Senator **Hawkins**. Mrs. Broadman.

STATEMENT OF ELLEN BROADMAN, CONSUMERS UNION, WASHINGTON, D.C.

Mrs. **Broadman**. Madam Chairman and Senator Dodd, Consumers Union appreciates this opportunity to testify. Much of what I wanted to say today has already been said by Mr. Wechsler and Mr. Essary.

Today we live in a world of banking miracles. Computer networks are spinning webs around the world, across the country and into our homes that perform virtually any banking function. Americans can travel to London and withdraw money through ATM's from accounts based in California. Washingtonians can pay their bills by telephone while vacationing in Alaska. Floridians can transfer money almost at the speed of light in the comfort of their homes through home computers. Millions of dollars can be transferred through the Federal wire system from coast to coast in fractions of a second. And yet, when consumers deposit an out-of-State check in a local bank they may have to wait 2 weeks before they can withdraw the funds. Even with local checks, consumers may have to wait as long as 1 week.

As we've heard in testimony today, these delays are an aberration in our world of today with our high technologies. They're very bizarre when we take a look at the check clearing system. Checks actually are cleared extremely fast in the direction of the paying bank. Local checks usually arrive at the paying bank within 1 day after deposit; and out-of-State check within 2 or 3 days after deposit.

But as we've heard today, it's the return process, the manual handling of checks through each of these institutions that handled them in the forward direction, that slows down check clearing, and causes banks to impose the unduly long and unnecessary hold on checks.

The Federal Reserve Board is studying this issue. In fact, they've studied it to death. They've discovered that consumers have had serious problems with check holds. For some people the delays are merely a bother, an irritation, forcing them to borrow funds or make other arrangements. For some, delays have created serious problems.

The 1981 Federal Reserve Board survey found that of the consumers who had bank accounts approximately 7 percent experienced serious problems due to holds and another 20 percent reported having some problems. At an earlier hearing, Senator Dodd conservatively estimated that somewhere in the vicinity of 50 million Americans have checking or savings accounts.

Projecting from this figure and the figures from the Federal Reserve survey, that somewhere around 10 million people have had problems with their accounts because of check holds; 3.5 million have had problems which they view as serious.

As we've heard from the Federal Reserve Board, the banking industry is well aware of the problem and has looked into it for years and years and years. And despite all these studies and despite considerable public discourse over this problem, the bankers have not really made significant changes.

It's not surprising that they have not made changes since they profit from these hold periods. They typically get provisional credit from a clearinghouse within 1 or 2 days and then have the use of those funds interest free for the rest of the hold period. So they're actually making money off the holds.

Although the Federal Reserve Board has said that it's unable to estimate how much banks profit, it seems pretty clear that the amounts are substantial.

Not only do banks profit from holds, but they would have to incur some expenses to update and reform the current check clearing system. So they in effect have two economic disincentives for making any change.

Because of bankers' natural resistance to this problem and because of the fact that no individual bank really can change the system, it's a problem that has to be dealt with on a systematic basis. We believe that Federal legislation is needed and we commend Chairwoman Hawkins for holding these hearings and Senator Dodd for introducing the bill to address this problem and to do something about this.

With respect to S. 573, Consumers Union does strongly support this bill and recommends a few changes in our testimony.

We believe that the disclosure requirements are absolutely essential. We should not rely on voluntary efforts by the industry. We should have uniform disclosures written in plain English that people can understand to let them know what the hold policies are so they can avoid problems and so they can avoid banks that have unusually bad hold policies.

S. 573 would also require two improvements in the check clearing process that hopefully would reduce holds. It would require bankers to adopt a uniform endorsement standard which we believe is needed so that the final paying bank, when a check bounces, can directly notify the bank of deposit and reduce the need for long hold periods.

We would suggest that in lieu of the uniform endorsement standard and the 24-hour notice period that's included in S. 573, that the bill adopt fixed limits on permissible hold periods. For example, the bill could restrict hold periods allowed on local checks to 2 business days, on in-State checks to 3 business days, and on out-of-State checks to 4 business days.

The bill could then authorize the Federal Reserve Board to adopt regulations including, if it felt appropriate, a regulation establishing uniform endorsement standards.

Given the history of this issue and given the resistance of bankers to change and the Federal Reserve Board's somewhat slow response in initiating change, we think it's important that the bill include specific limits on permissible holds.

This approach also would provide the industry with greater flexibility in deciding how to achieve the congressional goals contained in this bill, that is, reducing hold periods. In fact, there may be alternative ways of reducing holds that would be less expensive.

Senator **Hawkins**. Mrs. Broadman, I hate to interrupt, but time has expired, and we are under time constraints, and Senator Dodd has an appointment, as I do at 12 o'clock, so we are speedily running through this. Your entire statement will be entered in the record.

[The complete statement follows:]

TESTIMONY OF

ELLEN BROADMAN, COUNSEL FOR GOVERNMENT AFFAIRS WASHINGTON OFFICE, CONSUMERS UNION

Consumers Union[1] appreciates this opportunity to testify on S.573, a bill designed to reduce the holds financial institutions currently place on checks. We strongly support this legislation, with a few revisions.

Today, we live in a world of banking miracles. Computer networks are spinning webs around the world, across the country and into our homes that perform virtually any banking function. Americans can travel to London and withdraw money through ATMs from accounts based in California. Washingtonians can pay their bills by telephone while vacationing in Alaska. Floridians can transfer money almost at the speed of light in the comfort of their homes through home computers. Millions of dollars can be transferred through the federal wire system from one coast to the other in fractions of a second. And, yet, when consumers deposit an out-of-state check in a local bank they may have to wait two weeks before they can withdraw the funds. Even with local checks, consumers may have to wait as long as a week.[2]

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[1] Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide information, education, and counsel about consumer goods and services and the management of the family income. Consumers Union's income is derived solely from the sale of Consumer Reports, its other publications, and films. Expenses of occasional public service efforts may be met, in part, by nonrestrictive, noncommercial grants and fees. In addition to reports on Consumers Union's own product testing, Consumer Reports, with approximately 2.5 million circulation, regularly carries articles on health, product safety, marketplace economics, and legislative, judicial, and regulatory actions which affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

These delays are an aberration in our world of technological marvels. They linger as anachronistic reminders of a slower paced life that now is history. They seem so out of place, so out of step that they make us wonder how and why they continue to exist. Closer scrutiny of the check clearing process merely increases our bewilderment.

Banks process checks extremely fast in the direction of the paying bank. Local checks may be sent from the bank of deposit directly to the paying bank or routed through a local clearinghouse or correspondent. Local checks usually arrive at the paying bank within a day after deposit. An out-of-state check may be transferred by the bank of deposit directly to the paying bank or routed through a clearinghouse, correspondent bank, federal reserve office, or some combination of the above institutions. Out-of-state checks usually arrive at the paying bank no more than two to three days after deposit.

However, the return process for checks that bounce is extremely slow because they are handled manually and routed through the entire network of institutions that processed the check in the forward direction. Banks set hold periods to approximate the time required to identify a bad check. Holds thus cover both the forward and return check clearing process.

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[2] Senator Dodd, in his statement on S.573, described the results of a survey of 50 financial institutions in several metropolitan areas. Most of the banks surveyed would not credit a personal check drawn on an in-state bank for 5 business days (a week) and on an out-of-state bank for more than 10 business days (two weeks). 129 Cong. Rec. (February 23, 1983).

The unduly long holds placed on checks have resulted in serious problems for consumers, particularly for those who are unaware of hold policies.[3/] Consumers who move to new locations, for example, have been shocked to learn that they have to wait two weeks to gain access to money in accounts in their home state. For some, the delays are mere inconveniences that require them to borrow from friends or make other arrangements. For others, the delays create serious problems. Seven percent of the consumers with checking or savings accounts who were interviewed in a 1981 Federal Reserve Board survey experienced very serious or somewhat serious problems due to hold policies. Over twenty percent reported having some problems at least once. Over seventeen percent "got angry" and/or "lost money" because of holds.[4/] If, as Senator Dodd conservatively estimated at an earlier hearing, 50 million Americans have checking and savings accounts, a significant number of people have been adversly affected by holds. Extrapolating from the FRB figures, more than ten

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[3/] In a 1981 Federal Reserve Board survey, over nine percent of the accountholders reported that they had experienced problems because they were unaware of the hold policies of their bank.

[4/] Federal Reserve Board, Consumer Experience With Delayed Funds Availability (November 1981).

million would have had problems at least once, 3.5 million would have problems they view as serious, and over 8.5 million would have "lost money" and/or "got angry."

Both the Federal Reserve Board and the banking industry are quite aware of the problems holds create[5] and have studied various options for streamlining the check clearing system.[6] Yet, despite years of study, and despite the availability of obvious ways to reduce delays, neither has taken steps to reform the check clearing system to shorten holds to reasonable periods.

Bankers naturally are slow to make any changes since they profit considerably from the current delays. The bank of deposit typically receives provisional credit from a clearinghouse within a day on a local check and within two days on an out-of-state check. They then have the use of those funds--often interest free--for the remainder of the hold period. On an out-of-state check, for example, they may have the funds for twelve days and on a local check for five days before they allow account holders to withdraw their money. Although the Federal Reserve Board has stated that it is unable to estimate how much banks profit from hold periods, the amounts appear to be substantial. Bankers not only profit from holds, but they would have to incur expenses to reform the current system to reduce hold periods. These two economic disincentives have dissuaded bankers from speeding up the check clearing process.[7/]

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[5] In an earlier congressional hearing on this subject, Senator Chafee noted that "Federal Reserve Governor J. Charles Partee recently stated that in working with various consumer groups and State attorneys general, delayed funds is an issue that 'comes right to the top as an area that is most complained about.' Federal Reserve Governor Nancy Teeters has stated that next to monetary policy, she is asked most about check holds." Hearings on Delayed Funds Availability before the Subcommittee on Consumer Affairs of the Committee on Banking, Housing, and Urban Affairs, 97th Cong. 2d Sess. 1 (March 10, 1982).

[6] In 1978, for example, the Federal Reserve Board convened a "Delayed Funds Availability Task Force," consisting of representatives from the American Bankers Association, bankers and FRB staff, which issued a final report and recommendations on February 16, 1979.

Because of their continued resistance to change and because of the FRB's failure to initiate any significant responses, legislation is needed to bring the check clearing process into the twentieth century.[8/] We commend Senator Dodd for introducing S.573 and Chairwoman Hawkins for holding these hearings to address this problem.

[7/] Some individual banks have adopted more enlighted hold policies than others. Some have blanket policies that apply to all customers, unless special exemptions are sought. Others authorize bank employees to apply selective holds in situations in which banks are most vulnerable to fraud. Some do not impose hold requirements on long-standing customers, while others apply holds to such customers even if the customer has an unused line of credit that exceeds the amount of the checks they deposit.

[8/] The Federal Reserve Board has not even taken the small step of issuing regulations establishing that a bank's failure to disclose its hold policies consitutes an unfair banking practice. The FRB has had authority to issue regulation proscribing unfair banking practices since 1975 but has never exercised that authority.

DISCLOSURE REQUIREMENTS ARE NEEDED

S.573 would require financial institutions to notify customers about hold policies when they open an account and when they make deposits. CU supports such disclosures. Banks may need to impose holds in some cases to protect themselves against check-kiting and fraud. But basic notions of fairness dictate that they let customers know about these practices. This allows consumers to select an appropriate account and to take precautions to avoid problems. These disclosures also should enhance consumer awareness of hold policies and force financial institutions to compete to reduce hold periods.

We suggest that the bill be amended to allow institutions to disclose hold practices at all locations where deposits are accepted (e.g., teller windows, ATMs), in lieu of disclosure on each deposit slip. This may reduce compliance costs to institutions while assuring that customers know about hold practices. Also, financial institutions that change their policies could more quickly update disclosures at deposit locations. We also suggest that institutions be required to disclose this information clearly and conspicuously in language that customers can easily understand.

INTEREST ON DEPOSITS

S.573 would require institutions to pay interest on a check deposited in an interest bearing account from no later than the date the institution receives provisional credit for the check. Any delay in crediting an account beyond that date amounts to a hidden charge that consumers are unlikely to identify and that is inherently unfair. Once institutions can invest and profit from an accountholder's funds, they should pay interest on those sums at the rate agreed to when the account was opened.

LIMITS ON HOLD PERIODS

S.573 would require two fundamental improvements in the check clearing process that should obviate long hold periods. First, bankers would have to adopt a uniform endorsement standard (to be spelled out in Federal Reserve Board regulations). A uniform endorsement standard is needed so that institutions can identify the chain of institutions through which a check has cleared and determine which was the original bank of deposit. Because they currently are unable to decipher the bank of deposit, they must use the time consuming process of sending the check back to the institution from which they received the check, which in turn routes the check back through the network that processed it in the forward direction. With uniform endorsements, banks will be able to identify and promptly notify the bank of deposit if a check bounces. This will allow that bank to reduce the hold periods it needs to protect itself against fraud.

Uniform endorsement standards must be adopted on an industry-wide basis to be effective. No single bank can control or predict where checks drawn on that bank will be deposited nor how the check will be returned. Thus, no single bank can make sure that the endorsements on checks will be structured so that the original bank of deposit is easily decipherable unless all other banks agree to the same format. For this reason, legislation is needed to bring uniformity and sense to the check endorsement system used by financial institutions.

Second, S.573 would require the paying bank to notify the original bank of deposit within 24 hours after learning that a check of $250 or more had bounced. This requirement should significantly reduce the hold periods banks need to protect themselves against fraud. By limiting the notice requirement to checks of $250 or more, the bill reduces the cost to institutions of providing prompt notification, while assuring that customers have fairly prompt access to significant deposits.

In lieu of the above, Congress could directly limit hold periods. For example, it could restrict the hold periods allowed on local checks to two business days, on in-state checks to three business days and on out-of-state check to four business days. The bill could authorize the FRB to adopt regulations, including regulations establishing uniform endorsement standards, that would assist bankers in meeting these deadlines. This would provide the industry with greater flexibility in achieving the congressional goals embodied in the notification requirement, while assuring that hold periods are reasonable. Such requirements also might allow the banking industry to develop less expensive systems for reducing holds. Thus, although the requirements set forth in S.573 represent a step in the right direction, CU views fixed time limits as the optimal approach.

DELEGATION OF RULEMAKING POWER TO THE FRB IS TOO BROAD

S.573 authorizes the Federal Reserve Board to issue regulations to carry out the Act. The bill would empower the Board to create exemptions or adjustments for classes of transactions "as the Board determines are necessary." But, the bill fails to specify for what purpose the Board must find exemptions to be necessary. Can exemptions be created, for example, because the Board finds them necessary to improve its popularity among institutions? Although such action is highly unlikely, this example illustrates the breadth of authority the bill would delegate to the FRB. Other statutes, such as the Truth in Lending Act, have limited the circumstances under which the Board may create exemptions or adjustments. CU suggests that the Board be allowed to create exemptions it finds "necessary to effectuate the purposes of this Act, to prevent circumvention or evasion thereof, or to facilitate compliance without undermining the Act's purposes." This language closely tracks the Truth in Lending Act, 15 U.S.C. Section 1604(a).

CONCLUSION

In conclusion, Consumers Union urges this subcommittee to pass S.573 with the amendments we suggest so that consumers will be informed about the holds placed on their checks and so that the hold periods will be reasonable. Check clearing should be brought in line with the other highly sophisticated financial services bankers provide.

Senator **Hawkins**. Senator Dodd has some questions.

LACK OF FED ACTION WILL REQUIRE LEGISLATION

Senator **Dodd**. Just very, very briefly. First, let me thank all three of you for coming and for your testimony this morning.

Mr. Wechsler, you made some specific recommendations. You may have heard—I presume you were in the room—I think you were—when Mr. Martin was here and you heard his response to the suggestion that the Fed could basically do this through a simple regulation rather than going through the laborious process of legislation. You heard his response that unless you can actually trigger the existing statutes on fraud that the Fed would feel reluctant about proceeding.

I think that's an arguable point, but in light of the fact that there seems to be some reluctance on the part of the Fed to go the regulatory route, would you agree that we ought probably to proceed—and I realize you don't necessarily endorse every provision of S. 573, but there is some significant consistency in what you're recommending and what the bill suggests—that we proceed with the legislation?

Mr. **Wechsler**. Certainly, Senator. I think that if we're not going to get any action out of the Fed as it stands, that some legislation is better than none. What I would urge you to consider is the possibility of a statute that would direct the Fed to issue regulations such as have been discussed here if they are not able to do it under present law.

Senator **Dodd**. That would have been a good way to go until the Supreme Court recently. It looks as though we're going to have to be more specific in our legislation.

Mr. **Wechsler**. If we have to be more specific, then I'd like to see you pick up some of the details we've discussed here today.

Senator **Dodd**. You talked about the return trip as the more laborious trip and obviously the standards would improve that by allowing for the last institution to be aware of who the first institution was and communicate directly with them.

It's been suggested that the simple mail, using the simple mail telex, would significantly reduce the fraud and would be appropriate.

Do you see any objections to that?

Mr. **Wechsler**. No. I think that's a good idea.

Senator **Dodd**. Mrs. Broadman, I'm intrigued by your recommendation on disclosure. That sounds like a good idea to me actually, if the banks think that putting that disclosure on each instrument would be too costly. Your suggestion of putting the notice up where consumers would actually confront the institution at the teller window or wherever else, would satisfy that. I think that's a very good idea and I can't imagine an institution complaining that that's too costly to do, and I presume you would also insist upon it at the time that accounts were opened so the consumers would have the choice of shopping.

Mrs. **Broadman**. Definitely.

Senator **Dodd**. Mr. Essary, you have had some interesting experiences. Have you received an awful lot of calls or communications from others as a result of your reknowned troubles with a couple of New York banks? Did it provoke a lot of consumer interest?

Mr. **Essary**. Well, there was some difficulty in finding out where I was from an article that appeared about the initial problems, and yet something like 100 people contacted me by telephone or by mail after working to find out how to get in touch with me. I was rather overwhelmed that that many people were interested.

One of the key problems in that response is that there has been subsequent publicity and I subsequently found that there is a general capacity for the population, once confronted with a problem, once angry about it, not deciding, as I personally decided, to become committed to the issue, to tend to go on with their other problems. The question then becomes whether or not their banking problem is lessened, or because they're no longer outspoken about it, or because they are resigned to inconveniencing themselves with the way that they balance their bank books in order to deal with the problem.

What I mean by that is that subsequent publicity generates another 50 or 60 phone calls and letters, and the people who initially contacted me are less vocal about it than they were; nevertheless I think that's a pattern that doesn't prove that there's necessarily a lessening of concern. Instead, I think it's a dangerous pattern that indicates people become accepting intrusions in the way the institutions treat them without further protest.

Senator **Dodd**. I must say it's interesting. When Senator Chafee and I were here a year and a half ago and we raised these points, a reporter did a small story on it. I thought it was an important issue but certainly not one that was going to attract a lot of attention. The story appeared in the Connecticut papers. At that particular time, I don't know of another issue that generated as much mail in my office, and basically a lot of this stuff was, "I have never told anybody this before." It's almost like how do you explain to your local cleaning establishment that it's not really your fault, that you actually deposited the check? The assumption is that you screwed up, that you don't know what you're doing, that you can't manage your own simple accounts. And to go back to everybody you're doing business with and say, "Look, I'm really sorry. It wasn't my fault. There's a hold period." So people don't like to talk about it, in effect; and it's interesting how that kind of news can provoke a flood of people saying, "God, I'm glad someone is saying something."

Again, I don't want to suggest it was massive amounts of mail, but it was interesting that people did come forward and said, "This has happened to me and I haven't told anybody about it before."

Mr. **Essary**. Senator, I just wanted to comment that one of the reasons that you may have heard the statement that they never told anybody about it is that they didn't know who to tell.

When you go to buy a ticket at an airline, it's usually stated at the counter that you have a right to look at the tariffs and you have a right to contact the CAB or the FAA or whoever is regulating it. There is no notice in any banking transaction as to who you can contact that is regulating that bank if you disagree with its policy.

METHODS TO SPEED RETURN PROCESSING

Senator DODD. Mrs. Broadman, on your point about mandating a maximum hold period, I have expressed some reluctance about that only because I try to be sensitive to the lending institutions to the extent they deal with a variety of different customers and it may be necessary under certain circumstances to have a longer hold period because of the uniqueness of that particular customer or customers which I would not want to, in a sense, prescribe them from imposing. So I've been reluctant about doing what I know that New York and California did, and that is to actually mandate a maximum period.

I'll be satisfied if they disclose what their general policy is and particularly if the customer has a unique problem, then specifically what their hold period will be for that individual or business, and then, of course, the ANSI standard and the rapidity of getting back the information where you do run into a bad check situation.

So I would be interested to hear arguments to the contrary, but I feel that might be a bit more than even I would be willing to accept.

Madam Chairman, I thank you again profoundly for having these hearings and Senator D'Amato has asked to be a cosponsor of the legislation and I know you're thinking about it and want to take a look at it again, but my hope is that we can get something going here and be able to adopt something to eliminate or at least minimize the possibility of this problem arising. I would apologize in advance to a constituent of mine who is here, Mr. Hatch, who will represent the ABA with their point of view, and I will be glad to talk to him a little bit later, but I thank this panel for being here.

Senator HAWKINS. Thank you, Senator Dodd. We appreciate your offering this legislation. It's very timely and a very sensitive issue to so many people in the country. We understand your time constraint.

Professor Wechsler, do you have any data on how widespread the practice is of thrifts and banks in delaying funds?

Mr. WECHSLER. Well, I believe—I don't have that data myself, but I believe that these delayed funds holds are nearly universal. That is, you find them all over the country, although there are some banks, generally the smaller banks in the smaller communities, which indicate they do not impose either any hold or lengthy holds.

Senator HAWKINS. Is there any evidence, in your opinion, that banks deliberately hold checks beyond the time necessary to protect against bad check risk?

Mr. WECHSLER. I don't think that's so, Senator. I believe that they are doing this purely as a protective measure against losses on returned checks and the float that they have is just a nice side effect. I don't believe it's deliberate.

Senator HAWKINS. Do you know what the policy is of money market funds?

Mr. WECHSLER. No; I'm afraid I don't, although I believe my own does impose a hold.

Senator Hawkins. What would be the risk if Congress passed a law requiring that all checks be honored in no more than 5 days?

Mr. Wechsler. There would be some risk, but I would think that Congress at the same time would do something about speeding up the return process and that would cut the risk down significantly.

Senator Hawkins. Do bank customers have a remedy under State law when a bank has bounced a check for insufficient funds although there were sufficient funds on deposit?

Mr. Wechsler. I don't believe so, Senator. The Uniform Commercial Code allows banks to hold up funds for a reasonable time. There have been some court decisions, including a leading case in New York State, Rapp versus Dime Savings, and that reasonable time has been interpreted to include enough time so the bank can be reasonably sure that the check will not come back.

Senator Hawkins. To speed up clearing, could banks be assigned machine readable routing and transit numbers for the return of checks?

Mr. Wechsler. I believe so. I think the depository bank could use some kind of code. One banker mentioned to me the possibility of using a bar code such as is used in grocery stores and magnetic encoding might be used to speed up the return trip, the same way as is done on the forward trip.

Senator Hawkins. What is the ANSI standard for endorsements and would its adoption speed up the return of checks?

Mr. Wechsler. I support the ANSI standard. I believe that part of the problem here is that it's very difficult to identify where the check has to go to next and that's because, as has been indicated, endorsers stamp on top of one another and they have to be read by clerks.

Senator Hawkins. So it's not machine readable.

Mr. Wechsler. It's not machine readable. The ANSI endorsement standard would preserve readability and it would also, if you would want to take the further step, facilitate making them machine readable.

Senator Hawkins. Could the return trip be expedited by having the payor send the returned item directly back to the depository and to receive a credit for it from the depository?

Mr. Wechsler. I think it could. I think that would be another way to go. Direct notification is one way and direct return might be just as good.

Senator Hawkins. Can this be done under the UCC?

Mr. Wechsler. It can be, except, as has been mentioned here, there are five States that have not adopted this portion of the UCC, and I think there would be some question you would have to explore about whether Congress could override that.

Senator Hawkins. Would it help solve the problem to allow checks to be returned in the current manner, but to require the payor to directly notify the depository when the check is rejected?

Mr. Wechsler. I think that would be a big help, Senator, because that has the same effect as direct return. If the depository knows in advance that the check is coming back, then it knows it should not release the funds. He can get that notice much faster than he can get the check under the current system.

GOVERNMENT CHECKS DO NOT GET IMMEDIATE ACCESS

Senator Hawkins. So banks and thrifts give immediate access to Government checks?

Mr. Wechsler. No; I believe they do not. Many of them will hold a Government check for several days, some as long as they would hold a personal check.

Senator Hawkins. How about certified checks?

Mr. Wechsler. The same with certified checks.

Senator Hawkins. Bank checks?

Mr. Wechsler. The same for bank checks. The reason given is that they're concerned about forgeries and stolen checks. However, I point out in my statement that that is not an appropriate reason for these holds because even a 3- or 4-week hold will not protect a bank against a forgery risk on a forged endorsement. It could come back 2 or 3 months later. So these holds are not appropriate if we're talking about forgery.

Senator Hawkins. What about money orders?

Mr. Wechsler. I think money orders very likely would come in the same ball park, but I would like to think more about money orders. I would be happy if we could do this with bank, certified and Government checks. I think that would cover a large portion of the problem.

Senator Hawkins. There's a great number of the poorer citizens who use money orders almost exclusively as you know. Could you investigate and give us a report?

Mr. Wechsler. I think, Senator, probably those citizens are purchasing a money order and using it to pay a bill rather than receiving a money order. So perhaps it's not as great a problem.

Senator Hawkins. Should we require financial institutions with Government deposits to give immediate access or cash Government checks where proper identification is given?

Mr. Wechsler. It seems to me that one day would be appropriate because they don't get to use the money for one day.

Senator Hawkins. I really thank you for helping us on this question. There may be some others that we have that we'll submit for the record.

Mr. Essary, are you aware of cases where banks have refused to give immediate access to deposit of cashier's checks?

Mr. Essary. Yes, I believe that that came up in the discussion our committee had with Citibank, and they indicated that they didn't give immediate access. I believe that also was their testimony at the prior hearings here.

Is it possible that I might correct or illuminate upon something that was stated here?

Senator Hawkins. Surely.

Mr. Essary. Professor Wechsler mentioned Dime versus Rapp as being the statement by the courts relative to reasonable time, and I think that originally came up in the testimony of the Banking Association and they failed to point out that that case was limited to a situation where Dime Bank had an agreement between themselves and the depositors in writing. So the court did not rule on the reasonable time as having any relationship to whether a bank should give access to the money instantaneously or not. They only said because there was a written statement that in this particular case that that should apply.

Senator HAWKINS. Are you aware of cases where banks have refused to give immediate access to deposit of Government checks after proper identification?

Mr. ESSARY. Well, I don't cash Government checks so I'm not personally familiar with it.

Senator HAWKINS. Has it been your experience that banks get together and decide the clearing time and the charges?

Mr. ESSARY. Well, bankers get together all the time. I saw in the newspaper today that they got together with the President of the United States yesterday. I assume they discuss things with each other. I know when I'm at advertising conventions we talk about a lot of things going on.

There's a law against price fixing. I think it's probably a little difficult to get a grip on policy fixing and practice fixing, but I think those have the same economic end results as price fixing.

Senator HAWKINS. Has it been your experience that banks are not forthright in explaining to consumers why a check was bounced?

Mr. ESSARY. They are not. When you talk about banks not being forthright, the problem is that even the people who work for the banks are not aware. When I first brought up the question with my bank they submitted a sheet which is the average clearing time for in-town and out-of-town checks that was presented to that bank by the Federal Reserve Board. They said, "This is Federal Reserve policy." That was the statement of the teller to me. Knowing that wasn't true, I questioned other officers of the bank.

If you make a telephone call to the bank that I was using, they will tell you that the check will clear in a certain number of days. If you ask the teller, he or she will tell you a different thing. If you ask a manager, he'll tell you an entirely different thing. If you ask an executive, it's an entirely different thing. It's absolutely impossible for a consumer to know; yet if you ask, they simply say, "Ask us, we'll tell you."

Senator HAWKINS. Is the disclosure of a bank's policy on delayed funds the solution to the problem?

Mr. ESSARY. I'm sorry?

Senator HAWKINS. Is the disclosure of a bank's policy an answer?

Mr. ESSARY. Well, I think disclosure is only fair and obligatory. Despite all the publicity in New York State, despite an article in New York Magazine, people are not avid readers and they don't see all the publicity. It's still not common knowledge, for example, in New York State that Chemical Bank gives almost immediate access to your funds, and this is a major bank that has branches all over New York City and those depositors who have this as their primary concern have the opportunity to transfer their funds to Chemical Bank. But few have because few know.

DISCLOSURE OF BANK POLICIES NOT ENOUGH

Senator HAWKINS. A recently passed New York statute requires the State Banking Board to prescribe a reasonable period of time permitting the drawing on items received for deposit in a customer's account. It also requires the banks to notify each of its retail customers of its limitations on the customer's right to draw on deposited items. Will that help solve the problem?

Mr. Essary. Well, down in Texas from where I came, we have a statement that it's like putting the arsonist in charge of the fire department. What we're doing is we're institutionalizing bank delays. We're actually writing it into legislation and regulations which can be altered and changed and amended to the benefit of whoever happens to be lobbying for that particular situation. So I think it opens a Pandora's box, that it is frightening, that there should be no legislation that would provide for funds to customers at any time beyond that time which the banks have access to the funds themselves.

Senator Hawkins. Since the States are beginning to move in the area, is Federal legislation necessary?

Mr. Essary. I would hope that people would treat other people the way they should be treated, and the way they would like to be treated, and that the banks would take a humanistic approach to their consumer problems. But since they don't seem to do that, then I think that the Federal Government is right to help them along.

Senator Hawkins. Thank you very much. You have been most helpful in your actions before this committee and other areas.

Mrs. Broadman, what is the reaction of consumers to bank check clearing and cashing policies?

Mrs. Broadman. Of the consumers who have experienced problems, many have gotten angry. The Federal Reserve Board in their 1981 survey found a rather substantial number got angry. Over 17 percent either got angry or lost money because of holds. Consumers don't like them. Obviously, people would rather have prompt access to their money and when they don't know about hold policies and discover they can't get that access, they get angry.

Senator Hawkins. Is there any evidence that banks discriminate against our older citizens and retirees in their deposit account policies?

Mrs. Broadman. I don't have any information on that subject.

Senator Hawkins. In your opinion, would disclosure of bank practices solve the problem?

Mrs. Broadman. I think disclosure is a very important first step.

Senator Hawkins. As you suggested, maybe a big sign by every teller.

Mrs. Broadman. Where the money is deposited. I think it's very important and it's an important first step. I don't think disclosure alone is enough.

Senator Hawkins. Should money market funds and thrifts be covered too?

Mrs. Broadman. Sure. I'd like to clarify to our statement on why we support fixed holds. I realize there are problems and the different banks clear checks differently so that some may need a somewhat longer hold period than others and that there may be special situations where longer hold periods are needed. But I think through legislation we can set general hold limits and allow exceptions for exceptional circumstances, but at least have some sort of outer parameter that will make sure that people do get prompt access to their money.

Senator HAWKINS. Thank you three very much. You've helped us in perfecting legislation that's before us and we thank you for being interested in this problem.

We'd like to call our second panel consisting of representatives of the American and the Consumers Bankers Associations. I wish to welcome Mr. James Hatch, a constituent of Senator Dodd, who is president of Canaan National Bank, and Mr. D. Lee Falls, who is vice president of the Bank of America in San Francisco. Mr. Hatch is accompanied by Mr. Robert Kaminski, who has been active in the American National Standards Institute on check endorsements.

We're really rushed for time. I don't know where we have time to have lengthy hearings, but your complete statements will be entered in the record and maybe you could take a minute or so to tell for the record your positions, starting with Mr. Hatch.

STATEMENT OF JAMES HATCH, PRESIDENT, CANAAN NATIONAL BANK, CANAAN, CONN., ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION, ACCOMPANIED BY ROBERT J. KAMINSKI, VICE PRESIDENT, CHECK PROCESSING OPERATIONS, CONTINENTAL BANK, CHICAGO, ILL.

Mr. HATCH. Thank you, Madam Chairman. It's a pleasure being here today. I have submitted a full statement for the record. I have a summary of that statement and I think given the time constraints I will summarize the summary for you.

I'm president and chief executive officer of the Canaan National Bank in Canaan, Conn. Incidentally, that is one of those endangered species that was discussed earlier. It's a community bank of about $25 million in a town of 3,000 people.

I'm testifying here today on behalf of the American Bankers Association which consists of over 13,000 commercial banks which is more than 90 percent of the commercial banking community. With me today for technical support on any questions that might arise regarding the ANSI standard that has been discussed is Mr. Robert J. Kaminski, vice president of check processing operations for Continental Bank in Chicago, Ill. Most important, he's the chairman of the ANSI committee which developed the ANSI standard.

We believe that the industry on a voluntary basis can, will and in fact is in the process of implementing procedures which will accomplish the disclosure objectives of S. 573 without adding an additional level of legislative and regulatory control over financial institutions. We agree with what we've heard about the need for disclosure.

Attached as exhibit A to our testimony is a recent mailing on the issue which includes a sample disclosure form which was sent to the chief executive officer of every member bank in the organization. This has also been played up in our weekly trade publication, "Bankers Weekly," as well as having received press coverage.

The sample form clearly sets forth for the customer the reasons why there may be delay in the availability of their funds, explains when these holds may occur; and gives a general rule on the length of any holds. There is further notice that specific information on individual items would be given upon their presentation for deposit. We would, therefore, in large measure accomplish the disclosure goals of S. 573.

The express goal of this voluntary program is to forestall legislative or regulatory initiatives. We feel we can do a better job given the flexibility inherent in a voluntary approach.

The second portion of S. 573 would mandate the payment of interest on deposits in an interest-bearing account, as soon as provisional credit is received, as long as the check deposited ultimately turned cut to be good. While our staff has no surveys or exact statistical data, there have been numerous forums where this issue has been discussed and from these it is clear that the overwhelming majority of banks in this country begin to accrue interest—within the terms of the account agreement— as soon as provisional credit is received.

Even assuming there may be some banks who do not choose to pay interest at the time provisional credit is received, the question is raised as to whether this is a subject which is rightfully the subject of Governmental proscription. What if these banks offer other services which are of far more value to the consumer than the diminished accrual of interest? Is it up to the government to make that judgment for the consumer? It is clear that the market contains clear and viable alternatives for the consumer should he choose to exercise them. Given the existence of these alternatives, it certainly does not seem appropriate to regulate a market that is functioning quite well.

As far as the ANSI requirements under the bill, we feel that it would reduce errors in the return process by facilitating identification of the bank of first deposit and subsequent endorsers. It would in all probability not contribute to an acceleration of the return time of checks since this procedure still must be done manually.

S. 573 would also require the direct notification of the bank of first deposit when a check for over $250 reaches the bank on which it is drawn and it is not paid. This is obviously an attempt to short-circuit the process that we've discussed here, and in so doing speed up check return times. It's a laudable goal, but there are a number of operational and legal problems which would impact its viability.

The cost consideration is very real. If we use the 1-percent standard for returned checks and there are 6 billion checks a year over $250, that would mean 60 million returned checks. The Fed pilot project in Dallas which was referred to by Vice Chairman Martin earlier, has indicated a cost of approximately $2 per check on a return. We're looking at an initial number of $120 million cost. If you lower the threshold below $250 it becomes an even more significant cost based on these initial findings.

In summary, Madam Chairman, it is the conclusion of our association that legislation is not appropriate given the industry effort of voluntary disclosure and the existing widespread practice of paying interest from date of provisional credit to the bank. In addition, mandated compliance with the ANSI check endorsement standard and requiring telephone notice of dishonor for checks over $250, could impose significant costs on our members, while having an insignificant impact on check return times or funds availability.

The existing competitive marketplace provides consumers with over 40,000 financial service providers from which to choose based on the range of services provided, including funds availability policies. We believe that the marketplace coupled with our voluntary disclosure program will address the concerns of S. 573.

Thank you for your consideration and I stand ready to answer any questions you may have.

Senator HAWKINS. Thank you, Mr. Hatch.

How many banks have voluntary disclosure as you discussed?

Mr. HATCH. I'm not aware of any statistics available on that.

Senator HAWKINS. Where could we get that information?

Mr. HATCH. Our association will attempt to identify that information and return it to you.

Senator HAWKINS. Does your bank do it?

Mr. HATCH. Our bank does do it. We do it both at the time the account is opened and in the teller line. I might add that in our bank we know our customers relatively well and only under unusual circumstances do we find any need to place holds on available funds.

Senator HAWKINS. Do you have holds on Government checks?

Mr. HATCH. We do not have holds on Government checks. Our computer system automatically allows for a 3-day hold on any check deposited with us and that shows us the so-called available balance versus the current balance, but in all cases we work off the current balance unless we are concerned about, for some reason, the source of the deposit, the nature of the customer, the relationship with the bank.

[The complete statement follows:]

TESTIMONY OF THE
AMERICAN BANKERS ASSOCIATION
BEFORE THE
SUBCOMMITTEE ON CONSUMER AFFAIRS
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
ON S.573
THE FAIR DEPOSIT AVAILABILITY ACT OF 1983

SEPTEMBER 28, 1983

Madam Chairman and Members of the Subcommittee, my name is James Hatch and I am president and Chief Executive Officer of the Canaan National Bank in Canaan, Connecticut. I am testifying here today on behalf of the American Bankers Association. I am here to discuss the Association's position on S.573, The Fair Deposit Availability Act of 1983. With me today to provide technical support on any questions which might arise with regard to the American National Standards Institute (ANSI) check endorsement standard, is Mr. Robert J. Kaminski, Vice President of Check Processing Operations for Continental Bank in Chicago, Illinois. Mr. Kaminski was chairman of the ANSI Committee which developed the endorsement standard. I am pleased to be here today to place in the record our Association's views on S.573.

The issue of availability is one with which the banking industry is well familiar. It is a problem which is inherent in a system which relies on the physical movement of paper to call funds from distant accounts to the person possessing the paper. This is essentially what a check does. A check is not cash. It is an order to a bank to pay cash to the person who is the payee of the check. Until that piece of paper arrives at the bank on which it is drawn, no one is sure whether it will be honored as valid or returned unpaid for any of a variety of reasons. It is this uncertainty which leads banks to place holds on deposited funds. If all people were honest or did not make mistakes as to the balance in their accounts, there would be no delayed availability problem. Similarly, there would be no problem if everybody took the checks they wanted cashed directly to the institutions on which they were drawn, where the decision on the validity of the check and available funds could be made on the spot. This, of course, is not possible given the convenience and universality of a national payments system with many thousands of financial institutions participating.

Senator Dodd, in your remarks in the Congressional Record upon introduction of S.573, you made reference to the policy of placing holds on checks. You stated "In these days of electronic banking and automated clearinghouses, there is no excuse for these problems to occur with the frequency they do." Intuitively, it does seem rather incongruous that in a day and age where live television from outer space is common, and complex mathematical calculations can be done in fractions of a second on a computer the size of a credit card, that it can take up to several days to assure the validity of a check drawn on a bank in the next state.

Unfortunately, however, comparing space-age technology and automated clearinghouses with the check clearing system is the classic apples and oranges comparison. The development over the past several years of electronic banking and the automated clearinghouse for the rapid clearing of electronic payments, has given banking a broad new ability to effect very rapid and positive transfers of funds. Statistics of the National

Automated Clearing House Association show that from 1976 through 1981 the volume of payments made and recorded through electronic means increased by over 100% each year. Last year the volume increased by over 50%. Currently, over 350 million transactions are completed annually through automated clearinghouses. In addition, approximately three billion transactions are completed at automatic teller machines. The advantage to electronic banking is that it is so fast and is not subject to the delayed availability problem. For instance, if an employee takes his paper paycheck to the bank and deposits it, the bank may place a hold on it depending on who the employer is and who the employee/customer is, and their relationship to the bank. This is because the paper check, must be sent back to the employer's bank to be sure that it is good. (This example assumes the employee and employer have different banks). On the other hand, if the paycheck is directly deposited by the employer via an electronic funds transfer to the bank account of the employee, it is and by federal law must be available to the employee for withdrawal on that payday. In the first instance the employee has presented to the bank an order to the employer's bank (a check) which the employer's bank must then go out and collect. In the case of direct deposit, however, the employer's bank has electronically sent the money directly to the employee's bank.

The consumer has typically used the check as a means to obtain cash or as a medium of payment for goods and services. The banking industry, recognizing the weaknesses of the paperbased check system, has with the advent of electronic technology, moved toward alternatives which will offer convenience never attainable with a check.

There are currently over 30,000 automatic teller machines in operation in this country, a number which increases virtually every day. In the past few years, numerous regional and national systems have developed which electronically link these machines. These shared systems allow the consumer to use his own bank ATM card to get cash from any of a number of machines owned by various financial institutions throughout the region, state, or nation. We are already seeing media campaigns promoting these systems and banks who are members. Instant access to cash via an ATM has already become a common occurrence within a town or state. These systems will expand that availability and convenience geographically. It is already possible to make a coast to coast cash withdrawal which takes only a matter of seconds to process.

Similarly, there has been a move to point-of-sale terminals in retail establishments. These terminals use the customers ATM card to instantly transfer the amount of the purchase from the customer's bank account to that of the merchant without any cash ever changing hands.

In each of these cases, the validity of the card, user, and the account balance can be verified electronically and the transfer effected immediately, thus eliminating the delay and uncertainty of a check.

The object of this rather lengthy discourse is to try and differentiate two separate and distinct payment systems which exist today. One is paperbased (check) and the technology upon which it is based (i.e., the transfer of paper among a series of individuals) can be traced back hundreds of years. The other, electronic funds transfers or electronic banking is about 15-20 years old and like any teenager can do many things its grandfather cannot. We include this section in our remarks in an attempt to dispel any confusion as to the relationships that were thought to exist between these two payment methods. We also include it to hopefully illustrate that this issue of holds on checks is endemic to a paperbased payment system. The Federal Reserve Board has over the past several months, for reasons generally unrelated to this issue, attempted to speed up the Fed's check processing system. While there has been some progress made, the requirement of physically moving the check through the system and back again if it is not paid, remains a time consuming process.

Banks have a public trust and a duty to manage funds to assure the safety and soundness of their institutions. If bankers allowed the immediate withdrawal of funds on a universal basis, many banks could be exposed for losses in excess of their capital should a number of them turn out to be bad. Such a policy would leave institutions wide open to check kiters who juggle worthless checks between accounts at various institutions and abscond with real dollars drawn on phantom balances. Clearly then, banks need to take some precautions to guard against losses from fraud and other types of dishonored checks. In fairness to our customers though, we owe them an explanation of why we do it and at least a general statement of our policy on the issue at the time the account is opened, with more specific information on individual items.

Our Association is concerned that consumers be made aware of the availability policies when they deposit a check drawn on a different financial institution. In fact, I think it is fair to say that our major difference with the disclosure objectives of S.573 is with its intent to attain them through legislative and regulatory means.

Our industry has been very heavily legislated and regulated over the past half century. We are just now starting to shed some of these bureaucratic shackles, and are beginning to enjoy some of the freedom of the market place. We believe that the industry, on a voluntary basis, can, will, and in fact is in the process of implementing procedures which will accomplish the disclosure objectives of S.573, without adding an additional level of legislative and regulatory control over financial institutions.

Attached as exibit A to our testimony you will find a recent mailing which was sent to every member bank in our organization. The cover letter from the President of our Association, alerts our members to the seriousness of the problem, and refers to the attached policy statement and sample disclosure form. The policy statement is an example of a possible internal bank policy on placing holds on checks. Secondly, and more importantly to this Committee, is a sample disclosure form for when an account is opened.

This sample form clearly sets forth for the customer the reasons why there may be a delay in availability of their funds, explains when these holds may occur; and gives a general rule on the length of any holds. There is further notice that specific information on individual items would be given upon their presentation for deposit. We would, therefore, in large measure accomplish the disclosure goals of S.573.

In addition to the mailing which was sent to each chief executive officer, this issue has received prominent play in "Bankers News Weekly", our Association's weekly newspaper, which covers current banking news, and is sent to each member bank. The text of the sample policy statement and the sample disclosure form were featured along with an article reiterating the call for voluntary action.

The express goal of this voluntary program is to forestall legislative or regulatory initiatives. We feel we can do a better job given the flexibility inherent in a voluntary approach. A legislative proposal, no matter how innocuous it may seem on its face, in practice never functions in its intended manner. This is especially true when a regulatory gloss is added. An example which comes to mind is the simple and valid concept that lenders should disclose what interest rate they charge on loans. This simple sounding project was undertaken by legislators and regulators 15 years ago and today Truth-in-Lending represents one of largest and most complex federal regulations in existence. The idea of a simple way of conveying the most relevant information to the consumer, over the years got caught up in the cogs of the legislative and regulatory bureaucracy.

We are aware of the legislative efforts on this issue in both New York and California, which will mandate disclosure by financial institutions of their availability policies and require availability within a "reasonable" time. Both of these statutes are brand new. Neither will be fully implemented until sometime next year, thus, it is impossible to assess their effect at this point. Needless to say, however, we oppose any form of required availability schedule and feel, as discussed earlier, that a voluntary approach is the best solution.

Interest on Provisionally Credited Funds

The second portion of S.573 would mandate the payment of interest on deposits in an interest bearing account, as soon as provisional credit is received, as long as the check deposited ultimately turned out to be good. While our staff has no surveys or exact statistical data, there have been numerous forums where this issue has been discussed and from these it is clear that the overwhelming majority of banks in this country begin to accrue interest, (within the terms of the account agreement), as soon as provisional credit is received.

Even assuming there may be some banks who do not choose to pay interest at the time provisional credit is received, the question is raised as to whether this is a subject which is rightfully the subject of governmental proscription? What if these banks offer other services which are of far more value to the consumer than the diminished accrual of interest? Is it up to the government to make that judgment for the consumer? It is clear that the market contains clear and viable alternatives for the consumer should he choose to exercise them. Given the existence of these alternatives, it certainly does not seem appropriate to regulate a market that is functioning quite well.

ANSI Standard

The bill would also require compliance with the check endorsement standard promulgated by the American National Standards Institute (ANSI). While compliance with this standard would certainly reduce errors in the return process by facilitating identification of the bank of first deposit and subsequent endorsers, it would in all probability not contribute to an acceleration of the return time of checks since this procedure still must be done manually.

During the development phase of the ANSI endorsement standard, there was some discussion of the adoption of a standard for machine readable endorsements. However, the final conclusion of the ANSI working group was to adopt a standard which was more closely compatible with existing technology. A copy of the standard is attached as Exhibit B. It was hoped that such an approach might be more conducive to voluntary industry compliance. Despite this attempt to stay within the bounds of existing technology, there remains operational and technical problems for many of the larger banks in attempting to comply with the standard.

Direct Notification of Returns

S.573 would also require the direct notification of the bank of first deposit when a check for over $250 reaches the bank on which it is drawn and it is not paid. The apparent intent of this provision is to short circuit the process of physically returning the check through all the banks that handled it before the bank of first deposit becomes aware that it has been dishonored. While this is a laudable goal, there are a number of operational and legal problems which would impact its viability. It is apparently assumed that this system would allow banks to release items over $250 after a much shorter period of time since the bank of first deposit would now only need wait until the check had reached the bank on which it is drawn. Once it reaches that bank, and the bank of first deposit does not get a telephone notice of dishonor, it could then be assumed to be good. However, what if the drawee bank fails to call? What if they call but the information gets mishandled internally? What if the check does not travel through the system in the usual time frame and thus, the notice of dishonor comes the day after you release the funds? What do you say to your customer when you take the $500 out of his account if you don't have a returned check in your hand stamped "insufficient funds"? What if the dishonoring bank calls the wrong bank or the wrong person at the bank?

All of these very plausible "what if's" will occur to the bankers of this country as well. Commercial practice and the uniform commercial code dictate that the way a check is returned is through the same order of intermediaries as its forward movement for presentment. Most bankers will not feel confident that the check is good until a sufficient number of days have passed to allow the actual return of the check. These fears of confusion or mistake are not without basis. Extrapolating percentages taken from an Atlanta Federal Reserve Board study done in 1979, there are in the neighborhood of six billion checks processed each year written for amounts in excess of $250. While the overall average percentage of checks that are returned is about 1-1.5%, it may very well be that the percentage of returns is higher for these large dollar items. Thus, in addition to imposing an immense cost on the industry to make telephone notice of dishonor, this approach would also contain a substantial opportunity for error. We think it is fair to say that this provision, if enacted, would impose operational burdens and costs far out of proportion to the questionable value of the intended results.

Conclusion

In summary, Madam Chairman, it is the conclusion of our Association that legislation is not appropriate given the industry effort of voluntary disclosure and the existing wide spread practice of paying interest from date of provisional credit to the bank. In addition, mandated compliance with the ANSI check endorsement standard and requiring telephone notice of dishonor for checks over $250, could impose significant costs on our members, while having an insignificant impact on check return times or funds availability.

The existing competitive marketplace provides consumers with over 40,000 financial service providers from which to choose based on the range of services provided, including funds availability policies. We believe that the marketplace coupled with our voluntary disclosure program will address the concerns of S.573.

Thank you for your consideration of my remarks and I stand ready to answer any questions you may have.

AMERICAN
BANKERS
ASSOCIATION

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Washington, D.C.
20036

PRESIDENT
William H. Kennedy, Jr.
Chairman of the Board
National Bank of Commerce
P. O. Box 5208
Pine Bluff, Arkansas 71611

August 2, 1983

Dear Fellow Banker:

Recently, heightened Congressional and regulatory concern over delayed availability of consumer funds has built serious pressure for legislation to force disclosures of funds availability policies and/or require that funds be made uniformly available within a rigid time frame. These pressures are at work at both the state and federal levels.

An ABA banker task force considering this threat has suggested that certain voluntary actions by bankers could relieve much of this public and political concern. Specifically, the bankers on the task force have suggested that adoption of a bank policy statement on funds availability and use of a consumer disclosure statement could remove much of the confusion which is causing customer misunderstandings.

We believe strongly that no uniform, nationwide policy could be made to work. However, if each bank made clear its own necessary policies in statements to its customers and employees, the suspicions surrounding the matter of funds availability could be cleared away to a large extent.

Attached are a sample policy statement and sample customer disclosure statement which might be of help to you as you consider this matter.

If you have any questions about these suggestions or the use of these samples, please feel free to write me in care of the American Bankers Association.

Sincerely,

William H. Kennedy, Jr.

William H. Kennedy, Jr.
President
American Bankers Association

Sample Policy Statement

Holds on Retail Customer Accounts

It is ____(name of bank)____'s policy to place holds on customer accounts to reduce the risk of check kites and of checks returned for insufficient funds or any other reason to customer accounts in which the balance is insufficient to cover the returned item.

Generally, holds will be placed on checks deposited from sources not known to the bank in newly opened retail customer accounts. A new account is considered to be one that has been open for no more than (period of time - e.g., one month, six months or other). In addition, unusually large items deposited to an account, such as those over __(dollar value, e.g., $500)__ may also have a hold placed on them.

The length of a hold will reflect the bank's normal experience in dealing with checks returned from the location on which the deposited item was drawn. Normally, the hold will not exceed ____ days from any location within the United States.

Customers will be informed at the time an account is opened of this bank's hold policy. (Include the following if applicable) And tellers will inform customers at the time a deposit is made on which a hold is placed of the applicability and duration of the hold. (Branch managers, personal banking officers, or other title), upon customer request, have the authority to release holds on items, in their discretion, when a customer is known to them, the drawer of the check is reliable, or other circumstances exist to justify releasing a hold. It is the policy of this bank to minimize the use of holds to the extent consistent with the safety and soundness of the bank and the avoidance of unnecessary losses to the bank.

Sample Disclosure Statement

Holds on Deposited Checks

When you deposit a check drawn on another bank, there is always a time delay before the check reaches the bank on which it was drawn and we receive payment. Our policy is to provide the earliest realistic availability of funds on deposited items. But we must reserve the right to place a "hold" for the amount of the check you deposit until we have collected those funds.

Normally, we would place "holds" on a check you deposit if:

(Include only those that apply)

1. Your account is new, and it has not yet developed enough history of activity for us to know you;
2. You deposit a check for an unusually large amount;
3. Your check is drawn on another bank or financial institution;
4. You make a cash back or split deposit;
5. Your check is issued by a person or organization whose reliability is not known to us.

(Use the following if applicable)

When we must place a "hold" on your deposit, it may be necessary for us to ask you not to withdraw these "uncollected funds" from your account. When this occurs, your teller will inform you that a "hold" has been placed on your check, and the estimated time it will take for the check to be paid. Normally, holds will be for _____ business days on checks drawn on banks in (town, city, state) and for _____ business days on checks drawn from outside this area.

Of course, deposits into any interest-bearing account will begin to earn interest as soon as they are made whether a "hold" is placed on the deposit or not. We hope this policy will not inconvenience you, and encourage you to speak with one of our officers concerning any questions you may have about this policy.

ANSI®
X9.3-1981

American National Standard Specifications for Check Endorsements

Secretariat

American Bankers Association

Approved March 2, 1981
American National Standards Institute, Inc

American National Standard

An American National Standard implies a consensus of those substantially concerned with its scope and provisions. An American National Standard is intended as a guide to aid the manufacturer, the consumer, and the general public. The existence of an American National Standard does not in any respect preclude anyone, whether he has approved the standard or not, from manufacturing, marketing, purchasing, or using products, processes, or procedures not conforming to the standard. American National Standards are subject to periodic review and users are cautioned to obtain the latest editions.

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Foreword

(This Foreword is not a part of American National Standard Specifications for Check Endorsements, ANSI X9.3-1981.)

In the past, placement of check endorsements has been at the discretion of the particular financial institutions acting as collecting or paying agents, or both, with no specific position mandated for various types of endorsements. Instead, primary positions established for particular and secondary endorsements were imprinted on each item in random order, often resulting in primary (bank of first deposit) endorsements being obscured by secondary ones. Lengthy endorsements and light ink color only tended to increase such occurrences. Even if the endorsements were legible, inspection was time consuming without an assigned location. These inadequacies have in general delayed and complicated exception item processing.

In order to overcome such problems, a Joint Exception Item Task Force, consisting of members of the American Bankers Association, the Bank Administration Institute, and the Federal Reserve and commercial bankers, made recommendations to the American National Standards Institute on standardizing endorsements. ANSI assigned this proposal to American National Standards Committee on Financial Services, X9, which reviewed it initially on November 15, 1976. The committee agreed that the proposal had merit and therefore created a subcommittee to undertake the development of the present document, American National Standard Specifications for Check Endorsements, ANSI X9.3-1981.

This standard provides specifications to financial institutions and their customers on endorsement content and color as well as separate placement for four kinds of endorsements: first reader sorter, subsequent reader sorter, encoders and microfilmers, and payees. The establishment of these specifications is considered an initial step leading toward automation of the return item process and reduction of related exception item processing costs. In the development of this standard, every attempt has been made to maintain compatibility with existing equipment.

Suggestions for improvement of this standard will be welcome. They should be sent to the American National Standards Institute, Inc, 1430 Broadway, New York, N.Y. 10018.

This standard was processed and approved for submittal to ANSI by American National Standards Committee on Financial Services, X9. Committee approval of the standard does not necessarily imply that all committee members voted for its approval. At the time it approved this standard, the X9 Committee had the following members:

John Petrusky, Chairman
Andrew N. Ernst, Secretary

Organization Represented	*Name of Representative*
American Express Company	Robert S. Newman
Bank Administration Institution	David M. Smith
Bank of America	Russell Fenwick
Burroughs Corporation	Jerry S. Foley
Canadian Bankers Institute	Thomas Anderson
Chase Manhattan Bank N.A.	Stephen Hirsch
Chemical Bank	W. Robert Moore
Citibank N.A.	Seymour Rosen
Close, Martin and Schreiber	Peter Gundell
Continental Illinois National Bank and Trust	Robert J. Kaminski
Cundata Corporation	Carroll Smith
Datasaab Systems, Inc	E. Roger Hotte
Delaware Trust Company	Douglas R. Wehr
Deluxe Check Printers, Inc.	Eugene Olson
Depository Trust Company	Robert A. Dick
Digital Equipment Corporation	Donald B. Holden
Diners Club	James Johnson
Eastman Kodak Company	Clyde Cawley
Equitable Life Assurance Society of the U.S.	William Herzog
Federal Reserve of New York (nonvoting advisory member)	Howard Crumb
First National Bank of Chicago	Norman E. Rahn

Organization Represented	*Name of Representative*
Hartford National Bank and Trust Company	Russell F. Pound, Jr
Interbank Card Association	Andrew Bean
International Business Machines Corporation	Jerome Svigals
Irving Trust Company	Donald R. Monks
Life Office Management Association	James Foley, Jr
Manufacturers Hanover Trust Company	Lawrence F. Womersley, Jr
Mellon Bank	Harry Obley
Moore Business Forms, Inc	Hugh Murphy
Mutual Institutions National Transfer Systems	Denis Manelski
National Association of Federal Credit Unions	Richard McConnell
National Bank of North America	Frank Penna
NCR Corporation	William Snyder
Pitney Bowes	Eugene Warzecha
Recognition Equipment, Inc.	Larry Resch
Republic Money Orders, Inc.	Richard W. Hammond
Rudco Industries	Albert Weller
Security Pacific National Bank	Larry Dorff
Telephone Computing Services, Inc.	Robert Hensel
Uarco, Inc	Louis Richards
U.S. Department of Commerce	Meredith Ferstrom
U.S. League of Savings Associations	O. Tom Thomas
Valley National Bank	Gene Saunders
VISA, USA	Irwin Derman

Working Group X9E3, which developed this standard, had the following members:

Robert J. Kaminski, Chairman

Louis L. Brown
Leonard Bullis
Lynn P. Carlton
George Kiriakos
C. Bogart Mott
John Person
David M. Smith
William Snyder
Harry L. Wallace

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American National Standard Specifications for Check Endorsements

1. Scope and Purpose

1.1 Scope. This standard is intended to provide uniformity of the endorsement process by specifying the placement and data content of endorsements. It is not intended to modify existing MICR standards for checks.

1.2 Purpose. This standard is intended to improve the payments mechanism, as well as the tracing and processing of exception items.

2. Definitions

cash item. As used in this standard, a cash item is any instruction to pay a sum fixed in money to a third party, such as checks, drafts, or electronic transfers of funds.

check. A term used generically throughout this standard to indicate a paper cash item.

depository bank. As used in this standard, a depository bank is a financial institution legally chartered or licensed to collect or pay cash items deposited by a company or individual, and to which an item would be returned in the event of nonpayment.

endorsement. Information used to transfer a negotiable instrument from one holder to another.

endorsement areas. Spaces on the reverse of a check reserved for endorsements according to functional role in the collection of cash items.

leading edge. The right edge of a check when viewed on its face.

MICR encoder. Any equipment that applies MICR E13B font characters to a check.

reader/sorter. Any automated equipment that machine reads MICR E13B font.

routing number. The numeric identifier of a depository bank as assigned by the American Bankers Association.

trailing edge. The left edge of a check when viewed on its face.

3. Physical Characteristics

3.1 Endorsement Ink

3.1.1 Company and individual endorsement ink colors shall be determined at the discretion of the endorser.

3.1.2 All other endorsements shall be of a dark color, such as black, blue, purple, or red.

3.1.3 To facilitate automated processing and audit trails (which utilize metallic and fluorescent ink technologies), endorsement information should be applied to checks with nonmetallic and nonfluorescent ink.

3.2 Endorsement Area Locations (see Fig. 1 and 2).

Areas 1, 2, and 3 are intended for the endorsements of depository banks (or their agents). Area 4 is intended for the endorsement of the payee and other holders prior to deposit.

3.2.1 Area 1 begins at the leading edge and extends 1-1/2 inches longitudinally from the leading edge.

3.2.2 Area 2 begins 1-1/2 inches from the leading edge and extends 1-1/2 inches.

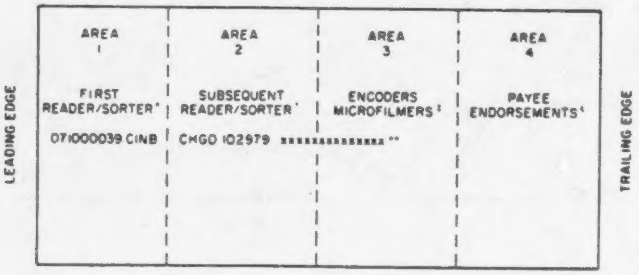
3.2.3 Area 3 begins 3 inches from the leading edge and extends to 1-1/2 inches from the trailing edge.

3.2.4 Area 4 begins 1-1/2 inches from the trailing edge and extends to the trailing edge.

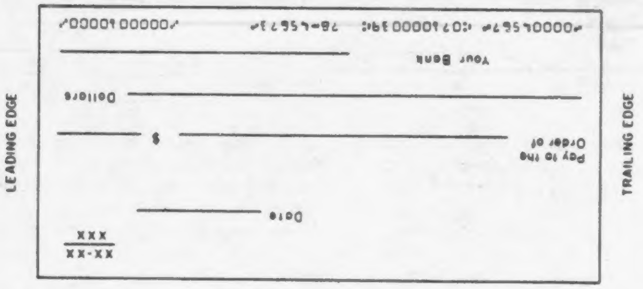
3.3 Endorsement Area Content

3.3.1 Area 1 is reserved for the first reader/sorter endorsement or the MICR encoding endorsement if it is in a linear form (see Fig. 1). At a minimum, the endorsement shall contain the bank's routing number, abbreviated name, and the date of endorsement, in that order. However, only the routing number must appear within area 1. Any additional information required by the endorser may extend into other areas if necessary. (See the example on the check in Fig. 1.)

3.3.2 Area 2 is reserved for subsequent reader/sorter endorsements. At a minimum, the endorsement shall contain the bank's routing number, abbreviated name, and the date of endorsement, in that order. However, only the routing number must appear within area 2. Any additional information required by the endorser may extend into areas 3 and 4 if necessary.



Back of Check
(a)



Front of Check (see Note)
(b)

*See 3.2.1 and 3.3.1.

†See 3.2.2 and 3.3.2.

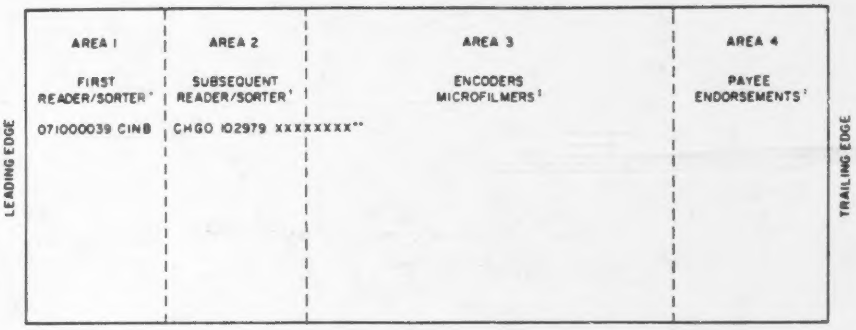
‡See 3.2.3 and 3.3.3.

§See 3.2.4 and 3.3.4.

**Linear method of endorsement.

NOTE: The front of the check is shown upside down so that the positions of the areas on the back with respect to the front of the check can be easily determined (that is, the payee endorsement is at the "Pay to the Order of" end of the check, and so forth).

Fig. 1
Personal Style Check



*See 3.2.1 and 3.3.1.

†See 3.2.2 and 3.3.2.

‡See 3.2.3 and 3.3.3.

§See 3.2.4 and 3.3.4.

**Linear method of endorsement.

NOTE: The position of the areas on the back of the check with respect to the front of the check is the same as for personal style checks (see Fig. 1).

Fig. 2
Back of Corporate Style Check

3.3.3 Area 3 is reserved for endorsements of depository banks (or their agents) applied by means other than as described in 3.3.1 and 3.3.2, such as MICR encoders with stamp only endorsements and microfilming machines. At a minimum, the endorsements shall contain the bank's routing number, abbreviated name, and the date of endorsement, in that order. However, only the routing number must appear within area 3. Any additional information required by the endorser may extend reasonably beyond area 3 in either direction.

3.3.4 Area 4 is reserved for the handwritten, hand stamped, or printed endorsement of the payee. The endorsement should include the payee's name, financial institution name, and account number. Commercial customers making use of machine-printed endorsements should attempt to configure their equipment to endorse in this area. If necessary, information may extend into area 3.

3.4 Dimension Tolerance. Check processing equipment is expected to exhibit minor differences in the alignment and skew of endorsement printing.

Senator HAWKINS. Mr. Falls, we would like to call on you at this time.

STATEMENT OF D. LEE FALLS, VICE PRESIDENT, BANK OF AMERICA, SAN FRANCISCO, CALIF., ON BEHALF OF THE CONSUMER BANKERS ASSOCIATION

Mr. FALLS. Thank you, Madam Chairman.

My name is D. Lee Falls. I am vice president of Bank of America. I am appearing on behalf of the Consumer Bankers Association. The CBA appreciates the opportunity to appear before this subcommittee to discuss the issue of delayed funds availability and to comment on the Fair Deposit Availability Act of 1983.

CBA believes that customers of depository institutions are entitled to have the use of deposited funds as rapidly as possible, consistent both with efficiency and with the safety and soundness of banks and the payments system. We have recognized for some time that consumers are often disappointed and frustrated by the length of time it takes for funds from deposits of checks to become available. We believe that much of this customer dissatisfaction stems from our industry's failure adequately to communicate our hold policies and their rationale. However, the need for delayed funds availability is caused by a basic structural flaw in the check collection system that adversely affects both banks and their customers. This flaw is not easily remedied. Since it is an interstate problem, we believe that attention must be paid to it at the Federal level. For that reason, CBA supports the concept of S. 573, which takes some important steps toward dealing with consumers' legitimate concerns.

In particular, we believe depository institutions should disclose their hold policies and practices to their customers in ways that permit customers to make informed decisions—no secrets or surprises. We also believe that funds deposited in interest-bearing accounts should begin to accrue interest as soon as the bank receives provisional credit. We don't want unjust enrichment. We are quite concerned, however, about the requirement in S. 573 that telephone notice be given if a check over $250 is not paid. This requirement would be very costly to banks and, ultimately, to their customers. We propose that the industry and the Federal Reserve cooperate to develop an alternative.

On the need for legislation, customer dissatisfaction with the delayed availability policies of depository institutions is beginning to express itself in State legislation. Both New York and California enacted legislation this year to address the problem.

And, incidentally, the speaker of the California Assembly received more than 7,000 letters in favor of that bill. That was primarily due to some newspaper articles in the San Francisco area alone.

Your subcommittee is now considering the advisability of enacting Federal legislation to deal with the same problem. The check collection system is a national system that should be governed by national standards. Therefore, we encourage enlightened Federal legislation to set national standards regarding delayed funds availability. Customers should not have different rights in this area depending upon where they deposit a check.

More fundamentally, State legislation could have an adverse effect on the payments mechanism or on the safety and soundness of the banking system. For example, the bill that became the California funds availability law initially proposed that a customer be presumed to be entitled to withdraw funds when the bank received provisional credit. If this presumption had been enacted, the measures necessary for the banks to protect themselves would have degraded the payments mechanism. That was our primary opposition to the bill for Bank of America in California.

Therefore, CBA encourages your subcommittee's efforts to find an equitable approach to meet consumers' concerns. We encourage you to apply that approach uniformly nationwide, preempting the conflicting laws of any State.

CBA believes that the Fair Deposit Availability Act of 1983 has a number of positive features that address the consequences of the structural flaw in the check collection system. First, CBA strongly endorses the concept that financial institutions should disclose to their customers their policies regarding funds availability. In that regard, we support the provisions of S. 573 that would require depository institutions to provide written disclosure of their general policy regarding availability of funds at the time an account is contracted for by the customer. We already have urged our members on several occasions to make this type of information available to customers.

We also believe that the customers should receive notice of the length of a hold at the time of deposit if there is any question whether or not a hold will be placed or of its duration.

CBA supports the concept of crediting interest to an interest-bearing deposit account no later than the date on which the depository institution receives provisional credit for the deposit.

SUGGESTIONS FOR IMPROVING S. 573

In order to improve S. 573, we make three suggestions. First, the lack of an efficient and timely notice of nonpayment to the depository bank is the basic flaw in the check collection system. However, the provision in section 6 of S. 573 that would require the payor bank to notify the bank of first deposit within 24 hours if a check of $250 or more is not payable does not remedy that flaw.

This provision does not specify whether notice is to be given by mail, wire, or phone. Telephone notice would be insufficient because it provides no proof that the payor bank has notified the bank of first deposit. Moreover, it would impose great costs on banks and their customers, because the number of returned items of $250 or more is prohibitively large and the cost, as the ABA mentioned, would be $100 million or more if you count long-distance telephone calls across the country.

Banks would have to increase service charges or decrease interest payments to depositors or both in order to cover the increased costs.

As an alternative approach to this problem, CBA suggests that S. 573 might require the Federal Reserve Board to develop regulations governing wire notice of nonpayment of checks, based on the Federal Reserve's current instructions that banks should use wire notice for items in excess of $2,500. The Federal Reserve Board might be authorized to make reasonable adjustments to the $2,500 threshold amount, in the interests of safety and soundness, efficiency, and protection of depositors. We believe the Federal Reserve Board and the banking industry can work together to devise a mechanism for wire notice of dishonor that will provide protection for depository institutions and improve funds availability for customers.

Our second area of concern is the civil liability section of S. 573, which essentially follows the Truth in Lending Simplification Act [TILA]. The philosophy underlying the civil liability provisions of TILA was that the act would be difficult to enforce because many creditors are not directly regulated by the Federal financial regulators. However, a Federal statute regulating funds availability practices of depository institutions can be enforced adequately through the regular compliance examinations conducted by the various Federal depository institution regulators.

Third, we agree that the creation of a speedy return system for dishonored checks is needed. We question whether statutory imposition of an endorsement standard, as section 5 provides, is the best way to meet this need. Solutions to the manual return system have been under study and discussion for many years by the Federal Reserve Board and various banking groups, but no cost-effective solution has been devised yet—and that's the key, cost-effective.

Rather than having legislation or regulation, the subcommittee might instruct the Federal Reserve to determine, in cooperation with the industry, the advisability of a standard for check endorsements. Among the standards to be evaluated would be the ANSI standard.

We think that S. 573 goes a long way toward fulfilling the reasonable expectations of customers concerning access to their funds, but it does not solve the basic flaw in the check collection system I described earlier. We believe there are some other avenues that we can explore.

Senator HAWKINS. Thank you, Mr. Falls.

Mr. FALLS. That concludes my statement.

Senator HAWKINS. We will enter the total statement in the record. We thank you for coming all the way from California to participate in these hearings.

[The complete statement follows:]

For Release on Delivery
9:30 A.M., E.D.T.
September 28, 1983

STATEMENT OF
THE CONSUMER BANKERS ASSOCIATION
BEFORE THE
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
SUBCOMMITTEE ON CONSUMER AFFAIRS
UNITED STATES SENATE

HEARINGS ON DELAYED FUNDS AVAILABILITY AND "THE FAIR DEPOSIT AVAILABILITY ACT OF 1983" (S. 573)

Madame Chairman:

My name is D. Lee Falls, and I am Vice President of Bank of America. I am appearing on behalf of the Consumer Bankers Association.*/ The Consumer Bankers Association appreciates the opportunity to appear before this Subcommittee to discuss the issue of delayed funds availability and to comment on "The Fair Deposit Availability Act of 1983" (S. 573).

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*/ The Association is a nonprofit organization organized in 1919 to provide a voice for the consumer banking industry. Today, membership in the Association is open to any federally insured depository institution, including commercial banks, thrifts, credit unions, and other providers of consumer financial services. Combined, the members of the Association now hold over 80% of total consumer deposits held by commercial banks.

The Consumer Bankers Association believes that customers of depository institutions are entitled to have the use of deposited funds as rapidly as possible, consistent both with efficiency and with the safety and soundness of banks */ and the payments system. We have recognized for some time that consumers are often disappointed and frustrated by the length of time it takes for funds from deposits of checks to become available. We believe that much of this customer dissatisfaction stems from our industry's failure adequately to communicate our hold policies and their rationale. However, the need for delayed funds availability is caused by a basic structural flaw in the check collection system that adversely affects both banks and their customers. This flaw is not easily remedied. Since it is an interstate problem, we believe that attention must be paid to it at the Federal level. For that reason, CBA supports the concept of S. 573, which takes some important steps toward dealing with consumers' legitimate concerns.

In particular, we believe depository institutions should disclose their hold policies and practices to their customers in ways that permit customers to make informed decisions. We also believe that funds deposited in interest-bearing accounts should begin to accrue interest as soon as the bank receives provisional credit. We are quite

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*/ For brevity, we shall often use the terms "bank" and "institution" in this testimony to mean a depository institution of any type. When we refer to banks strictly defined, we use the term "commercial bank".

concerned, however, about the requirement in S. 573 that telephone notice be given if a check over $250 is not paid. This requirement would be very costly to banks and, ultimately to their customers. I shall comment in detail on these matters later in my statement.

Before commenting on specific provisions of S. 573, I would like to provide some background on the present check collection system and its impact on the issue of delayed funds availability.

NATIONAL CHECK COLLECTION SYSTEM

The problem of delayed funds availability must be considered in light of the provisions of the Uniform Commercial Code, adopted by all states, and of the national check clearing system. When one bank takes for deposit a check drawn on another, it must send the check through the national check collection system to obtain the funds the check represents. Checks are collected through a correspondent bank, the Federal Reserve System, a local check clearinghouse, or by sending the item directly to the payor bank on which it is drawn. In most cases, some combination of these methods is used.

The forward process of sending a check to the payor bank generally takes one or two business days from the date the check is first deposited. The actual time required will depend on a variety of circumstances such as the number of intermediary institutions involved, holidays, weekends, weather, and mechanical breakdowns.

After receiving the check, the Uniform Commercial Code requires the payor bank either to pay it or to return it unpaid by midnight of the day following the day it receives the check. The depository bank receives "provisional credit" for the check according to an availability schedule which reflects normal processing and transportation time for the forward process only. This is usually one or two business days. Since it is unknown whether the specific check will in fact be paid, any such grant of credit must be provisional and may be revoked if the item is returned unpaid.

Because of the uncertainty whether it will receive final credit, the depository bank will be making a loan to its customer if it allows the depositor to withdraw funds at the same time that the bank receives provisional credit. In this situation, the bank is at risk that the item will be returned unpaid and that the provisional credit to it will be revoked. If this occurs, the bank may be unable to recover from its customer the funds withdrawn.

The forward check collection process is relatively fast, particularly since Magnetic Ink Character Recognition (MICR) encoding allows it to be accomplished through the use of high speed processing equipment. However, the return process is manual and therefore considerably slower.

A returned check must be processed manually because each endorsement stamp on the back of the check must be read to determine to which bank or institution the check must next be returned. Returning institutions frequently decipher as many as five or six endorsements, often stamped on top of one another, to determine to which institution the check must next be returned. Each bank in the return process is required to dispatch a returned check to the next succeeding bank by midnight of the next business day following the day of receipt or else be held accountable for the check. Usually the institution merely places the check in the mail by the midnight deadline. Accordingly, the return process normally takes at least twice as long as the forward process. There is no incentive for the payor bank to inform the bank of first deposit as rapidly as possible that a check has been dishonored.

The Federal Reserve System does suggest that a paying institution should wire notice to the bank of first deposit when a check of $2,500 or more is being returned unpaid. However, the Federal Reserve's wire advice provisions contain many ambiguities, such as the lack of any instructions as to whom wire notice is to be given, or within what time frames. These provisions also fail to provide any indication of the consequences for a bank that provides an incomplete or erroneous notice or fails to provide one at all. Moreover, the wire advice will not always provide enough information to permit the depository bank to identify readily the particular customer who deposited the check or the branch of the depository bank that first received it.

As a way of eliminating the uncertainty inherent in the return process, some have suggested that the depository bank telephone the payor bank directly to determine whether any item has been paid. In light of the approximately 125 million checks that flow back and forth across the country every day, this procedure simply would be infeasible.

RATIONALE FOR DELAYED FUNDS AVAILABILITY

Ninety-nine percent or more of all checks are paid upon presentment. It is the less than one percent that are not paid that require the placing of holds on the proceeds of some items in order to protect the safety and soundness of the banking system. If banks were not permitted to place holds, they would be open to substantial losses from both fraud and ordinary credit risk from funds advanced on items subsequently returned. Millions of dollars currently are lost in "check kiting schemes" each year. The only way a depository institution can protect itself fully against fraud and credit losses is to allow depositors to withdraw only against collected funds. Because of the delay involved in notification of return, hold times to protect the bank must be quite long, in some cases over twenty business days.

Another important factor causing banks to place holds is that both state and federal regulatory agencies supervising depository institutions have taken the position that allowing depositors to withdraw against uncollected funds is tantamount to extending unsecured credit to the depositor. Such credit extensions must be included in determining whether a financial institution is adhering to applicable legal lending limits and in analyzing whether the institution is acting safely and soundly as required by the banking laws.

NEED FOR LEGISLATION

Customer dissatisfaction with the delayed availability policies of depository institutions is beginning to express itself in State legislation. Both New York and California enacted legislation this year to address the problem. I have attached an Appendix to this statement that describes the history of the California Funds Availability Law and analyzes its provisions. Bank of America and all other California commercial banks urged Governor Deukmejian to sign this bill. Bank of America believes it sets forth new legal rights to which consumers are entitled.

Your Subcommittee is now considering the advisability of enacting Federal legislation to deal with the same problem. The check collection system is a national system that should be governed by national standards. Therefore, we encourage enlightened Federal legislation to set national standards regarding delayed funds availability. Customers should not have different rights in this area depending upon where they deposit a check.

More fundamentally, state legislation could have an adverse effect on the payments mechanism or on the safety and soundness of the banking system. For example, the bill that became the California Funds Availability Law initially proposed that a customer be presumed to be entitled to withdraw funds when the bank received provisional credit. If this presumption had been enacted, banks would have been compelled to take steps to protect themselves. The necessary measures would have degraded the payments mechanism.

CBA recognizes the need to deal with the problem caused by the structural flaw in the handling of return items, i.e., the lack of incentive for the payor bank to notify the depository bank as soon as possible that the check is dishonored. However, no cost-effective, workable procedure to create this incentive has yet been found, despite considerable study by the industry and the Federal Reserve. Therefore, CBA encourages your Subcommittee's efforts to find an equitable approach, short of a major reform, in order to meet consumers' concerns. We encourage you to apply that approach uniformly nationwide, pre-empting the conflicting laws of any State.

FAIR DEPOSIT AVAILABILITY ACT OF 1983

CBA believes that the Fair Deposit Availability Act of 1983 has a number of positive features that address the consequences of the structural flaw in the check collection system. First, CBA strongly endorses the concept that financial institutions should disclose to their customers their policies regarding funds availability. In that regard, we support the provisions of S. 573 that would require depository institutions to provide written disclosure of their general policy regarding availability of funds at the time an account is contracted for by the customer. We already have urged our members on several occasions to make this type of information available to customers.

Like the proposed Fair Deposit Availability Act, the Electronic Funds Transfer Act (EFTA) also mandates that certain disclosures be made to a consumer upon opening an account that is accessible electronically, which in today's environment encompasses the majority of accounts. These disclosures inform the consumer about charges that can be imposed, when accounts can be accessed, and other rights they possess. We believe that the EFTA disclosures and the proposed delayed funds availability disclosures should be given to the consumer on one document, since both serve the similar purposes of allowing consumers to shop for deposit services and of informing them of how and when they will have use of their funds. A single disclosure document would facilitate compliance by depository institutions with both EFTA and S. 573. At the same time it would promote consumer awareness of the terms and conditions of opening an electronically accessible account.

We also believe that customers should receive notice of the length of a hold at the time of deposit if there is any question whether or not a hold will be placed or of its duration. We find the disclosure requirements of section 3(b) of S. 573, which attempt to implement this concept, to be somewhat ambiguous. In order to avoid many of the problems depository institution experienced with the design of the Truth-in-Lending disclosures, we would be happy to provide suggestions to the Subcommittee on this particular section of the legislation.

We believe that Section 3(b) should be clarified to deal with two cases: first, when an institution has a general policy to delay availability on all checks, and second, when the institution does so only in particular cases. If a depository institution has adopted a general funds availability policy for all or most items, the customer already will be aware of the hold that will be placed from the written disclosure received at the time of opening an account. Therefore, we respectfully submit that mandating additional disclosure, such as on preprinted deposit slips or envelopes for automatic teller deposits, would be duplicative and unnecessary. We also note that deposit slips currently do not contain enough room to set forth this type of information. Instead, we suggest that an institution generally applying holds should make readily available at all locations the same disclosure of its general hold policy that it provides when an account is opened. For example, posters and brochures restating the institution's general hold policies might be placed in branches for customer information purposes.

If an institution only occasionally places holds on deposits, S. 573 should require "specific notice" as to when the customer may withdraw the funds. This requirement would not present any problems if the notice was given at the teller window. Written notification of the duration of a specific hold also could be provided by return mail in the case of a deposit made at an automatic teller machine, night depository, or by mail. While Bank of America's policy for many years has been to provide notification by return mail, we recognize that many institutions do not. Implementing this type of disclosure would increase bank's costs.

CBA supports the concept of crediting interest to an interest-bearing deposit account no later than the date on which the depository institution receives provisional credit for the deposit. Most CBA member institutions already have begun computing interest either on the date of deposit or when provisional credit has been received. It seems obvious that depository institutions who delay computing interest ultimately will lose customers in this highly competitive market. For this reason, we question the need for Federal regulation of an area that is already highly competitive and responsive to market demands. Of course, if interest will not be credited immediately, this fact should be disclosed to the bank's customers.

RECOMMENDATIONS

In order to improve S. 573, CBA makes three suggestions. As described above, we recognize that the lack of an efficient and timely notice of nonpayment to the depository bank is the basic flaw in the check collection system. However, the provision in Section 6 of S. 573 that would require the payor bank to notify the bank of first deposit within 24 hours if a check of $250 or more is not payable does not remedy that flaw.

This provision does not specify whether notice is to be given by mail, wire or phone. Telephone notice would be insufficient because it provides no proof that the payor bank has notified the bank of first deposit. Moreover, it would impose great costs on banks and their customers, because the number of returned items of $250 or more is very large (though they represent a tiny fraction of all checks handled in the forward check collection process.) This provision would result in higher service charges or lower interest payments to depositors (or both) in order to cover the increased costs. Because this type of notification would require an even more labor-intensive effort than the present system, it also conflicts with the concept of devising a more efficient system based on present and future electronic technology.

As an alternative approach to this problem, CBA suggests that S. 573 might require the Federal Reserve Board to develop regulations governing wire notice of non-payment of checks, based on the Federal Reserve's current instructions that banks should use wire notice for items in excess of $2,500. The Federal Reserve Board might be authorized to make reasonable adjustments to the $2,500 threshold amount, in the interests of safety and soundness, efficiency, and protection of depositors. In promulgating the regulations, the Federal Reserve Board must clarify to whom the notice is to be given and provide a specific time frame for notification. It also must specify the consequences of non-compliance with the regulations. We believe the Federal Reserve Board and the banking industry can work together to devise a mechanism for wire notice of dishonor that will provide protection for depository institutions and improve funds availability for customers.

Our second area of concern is the civil liability section of S. 573, which essentially follows the Truth in Lending Simplification Act (TILA). The philosophy underlying the civil liability provisions of TILA was that the Act would be difficult to enforce because many creditors are not directly regulated by the Federal financial regulators. As a result, a private right of action, with statutory damages and provisions for damages in class actions, was included in the TILA in order to promote compliance by all creditors. However, a Federal statute regulating funds availability practices of depository institutions can be enforced adequately through the regular compliance examinations conducted by the various Federal depository institution regulators. As noted in the legislation itself, the Federal regulators have a panoply of devices by which compliance can be ascertained readily by their examiners.

Furthermore, the damages provisions in Section 8 of S.573 establish liability far in excess of the potential harm to a customer. At most, it might be reasonable to impose liability for actual damages stemming from a depository institution's failure to comply with this legislation. However, the statutory and class action damages provisions of S. 573 far exceed any equitable consumer protection and merely would provide an incentive for unnecessary lawsuits. Defending those lawsuits would raise the costs of the banking industry and necessitate higher charges or lower interest payments for customers.

Third, we agree with Senators Dodd and Proxmire that the creation of a speedy return system for dishonored checks is needed. We question whether statutory imposition of an endorsement standard, as Section 5 provides, is the best way to meet this need. Solutions to the manual return system have been under study and discussion for many years by the Federal Reserve Board and various banking groups, but no cost-effective solution has been devised yet.

We applaud the efforts of the American National Standards Institute (ANSI) to develop national standards for check endorsements. However, implementing that particular standard would be costly and require several years. Since the general goal is to reduce the time required to notify depository banks of returned checks, CBA strongly believes that the banking industry should work collectively with the Federal Reserve System to develop ways to meet the goal rather than being confined to the one approach embodied in the ANSI standard. Therefore, we believe S. 573 should not require the Federal Reserve Board to issue regulations imposing an endorsement standard. Instead, the Federal Reserve might be instructed to determine, in cooperation with the industry, the advisability of a standard for check endorsements. Among the standards to be evaluated would be the ANSI standard.

SOLVING THE FLAW IN THE CHECK COLLECTION SYSTEM

CBA believes that S. 573 goes a long way toward fulfilling the reasonable expectations of customers concerning access to their funds. However, the legislation does not solve the basic flaw in the check collection system I described earlier in this testimony. We believe that there are at least three avenues that the Subcommittee could explore in order to develop a solution to this problem.

First, the Subcommittee might encourage the Federal Reserve System to continue to cooperate with the industry to minimize the effect of the inherent flaw in the check collection system. For example, the banking industry should make a serious effort to acquaint customers with the other services it offers that can provide collected funds far more rapidly. If customers knew that inexpensive, rapid, and final funds availability could be obtained by using fund transfer mechanisms other than checks, customers would specify them when engaging in transactions for which finality is important. For example, if a customer in Florida is selling property in New York, the customer could specify in the sales contract that a New York bank should send the proceeds by wire to the customer's Florida account, rather than receiving them in the form of a cashier's check upon which a hold might be placed. Funds sent by wire are available the same day, and there would be no reason for the Florida bank to place a hold.

In addition, the industry and the Federal Reserve should explore further the possibility of automating the flow of return items, just as the forward check collection process is now automated. Most important, cost-effective techniques for establishing an incentive for payor banks to notify depository banks of return of unpaid items should be developed.

Second, depository institutions might be encouraged to develop check truncation, a process whereby payor checks are stored at the bank of first deposit and the funds are transferred electronically. Since returns can then be done electronically, check truncation could significantly reduce delays in the present check collection system. Potentially, the time consumed in the whole process of presentation and return could be reduced to two or three days, regardless of the distance between depository and payor banks. At present, many of the nation's credit unions utilize check truncation with a high degree of consumer acceptance. However, because commercial banks handle so many more items than credit unions, which only recently began to offer share draft services, commercial banks have found it significantly more complex to implement check truncation.

Third, depository institutions should explore revisions to the Uniform Commercial Code in order to establish an incentive for the payor institution to provide rapid notice of dishonor.

This concludes my prepared statement, Madame Chairman. The Consumer Bankers Association would welcome working with your Subcommittee to develop ways to deal cost-effectively with consumer dissatisfaction with return item handling in the present check collection system. We all agree that the check collection system requires creative innovations to continue to serve depository institutions and their customers well in the future. We shall be pleased to answer any questions from you and the other members of the Subcommittee.

HISTORY AND ANALYSIS
OF THE
CALIFORNIA FUNDS AVAILIBILITY LAW

A. History.

Early in 1983, columnist Bill Mandel of the San Francisco Examiner published a description of his experience in attempting to collect a check drawn on an out-of-state bank. Mandel's bank had placed a hold for several days on the proceeds of his check, and he felt that this action was unjustified. Mandel asked his readers who agreed that something should be done about funds availability practices to clip from the newspaper a coupon requesting legislative action. He suggested the coupon be sent to the Honorable Willie Brown, Speaker of the State Assembly. Apparently some seven or eight thousand persons clipped the coupon and sent it to the Speaker. Shortly thereafter Speaker Brown introduced the legislation (A.B. 1723) that became the California Funds Availability Law.

Speaker Brown's bill required a written disclosure to the potential customer of a bank's general policy on when a customer may withdraw funds deposited by a check into the customer's deposit account. It required that the proceeds of a check deposited in an account be made available for withdrawal as of right within a reasonable time after the deposit had been forwarded by the bank for collection. A presumption was established that a reasonable time had elapsed either when the bank received provisional credit for the check or after five banking days, whichever occurred earlier. For failure to comply with any requirement imposed by the bill, the bill would have imposed liability along the lines followed in the Truth In Lending Act.

A.B. 1723 rapidly attracted several co-sponsors in both the California Senate and the Assembly. The California banking industry proposed several amendments to improve the bill. The bill required banks in most cases to make funds available in two days, which is long before the banks could know whether checks deposited were in fact collectible. The bill would have increased dramatically the potential for bank losses from check-kiting schemes. Nevertheless, amendments proposed by the banking industry to reduce the potential for losses were rejected by the bill's sponsors and the Assembly's Banking Committee. The bill passed the Assembly's Banking Committee without amendment, but was amended on the Assembly floor.

California's Uniform Commercial Code required that a check be returned through every bank in the collecting chain until it reached the bank of first deposit. It was impermissible for a bank to return a check directly to the bank of first deposit. This policy necessitated holds on in-state items longer than otherwise might have been necessary. The bill was amended to allow direct returns, potentially eliminating the unnecessary steps in the return process.

Before the bill was considered in the California Senate, Speaker Brown proposed an author's amendment to exempt savings and loan associations from the presumption concerning a reasonable time in which to make funds available. Instead, the amendment required the Savings and Loan Commissioner to adopt regulations defining a reasonable time for associations to provide credit to the customer for an item deposited.

In the interest of promoting equal treatment of savings and loan associations and commercial banks, the Speaker appeared before the Senate Committee on Banking and Commerce to support a further amendment requiring the State Superintendent of Banks to promulgate regulations defining a reasonable time for which a bank may impose a hold. In the waning days of this year's session, both houses of the legislature enacted the resulting bill. Governor Deukmejian signed it into law on September 23, 1983.

B. Analysis.

The California Funds Availability Law (A.B. 1723) states that it is California's public policy to provide retail banking customers with the right to withdraw against items deposited with any depository institution located in California within a reasonable period of time. The statute amends the California Commercial Code to:

(a) Authorize a payor bank to return an unpaid item directly to the initial depository bank;

(b) Permit withdrawal as of right of a customer's deposit in any case where the bank has received a provisional settlement, at the expiration of a reasonable time for the collection and return of the item, as prescribed in regulations issued by the appropriate state regulatory agency for that class of depository institution;

(c) Require written disclosure to potential customers of the bank's general policy on when a customer may withdraw funds deposited by check or similar instrument;

(d) Require depository institutions to furnish customers with preprinted deposit slips, envelopes for automatic teller machine deposits, or other individual notice bearing a conspicuous summary statement of the institution's general availability policy. In the case of a particular deposit on which a hold is placed, the institution must provide a specific time when the customer may withdraw the funds;

(e) Require depository institutions to begin computing interest on the date on which the institution receives provisional credit for a deposit into an interest-bearing account. A bank need not pay interest on a check returned unpaid; and,

(f) Impose liability for actual damages, for statutory damages, or, in the case of a class-action, such amount as the court may allow, but less than $500,000 or 1% of the net worth of the depository institution. Liability may not be imposed if the violation was not intentional and resulted from a bona fide error by the depository institution. There is a one year statute of limitations on an action for violation of the statute.

Each California depository institution regulatory agency must promulgate, and review annually, regulations to establish the reasonable time for funds to be made available. In determining what constitutes a reasonable period of time, the agencies must consider:

(a) The actual time for processing and transporting between the depository and payor institutions;

(b) The fastest air transport time between the depository and payor institutions; and,

(c) The most expeditious route and means for processing of returned items.

If applying the regulations would result in unsafe or unsound practices by a depository institution, its regulator may apply a different availability rule for that institution.

The legislative also stated its intent that the Funds Availability Law not affect the existing right of a depository institution to accept or reject an item for deposit. Thus, banks may continue to send items for collection in appropriate circumstances.

9/23/83

Senator **Hawkins**. Mr. Kaminski, as chairman of the working group of the ANSI standard, we will include your statement in the record if you have one. Will you answer some questions for us?

NEW TECHNOLOGY ADDS TO BANK COSTS

Mr. **Kaminski**. I have no formal statement, Madam Chairman, but I will be willing to answer some questions.

Senator **Hawkins**. Would you describe the composition of your working group and what was its mandate?

Mr. **Kaminski**. The composition of the working group consisted of bankers and the machine vendors that supply check processing equipment to the financial industry.

Our mandate was to improve on the endorsements placed on the back of checks by such types of equipment.

Senator **Hawkins**. Could you tell me how the standard would work and comment on whether all existing bank machines could stamp in the required places?

Mr. **Kaminski**. The objective was to identify the two most important check processing endorsements on the back of the check, and that's the bank of first deposit and the first high-speed processing institution.

As to all of the equipment that is out in the marketplace to endorse checks, some of it may go back as long as 50 years and, consequently, it's very difficult to identify some of that capability.

However, we did feel that the vast majority of the equipment could meet the standard based on the bank of first deposit endorsing the center of the check or in area No. 4 and area No. 1 for the first high-speed processing bank.

Senator **Hawkins**. What costs would be associated with the banks that use that standard?

Mr. **Kaminski**. The cost, it would be very difficult to identify as the item passes through more than three financial institutions. It's a matter of how you control the flow of work and by work I mean the numbers of checks that go into the computer processing rooms.

Senator **Hawkins**. The ABA testimony states that there remains operational and technical problems for many of the larger banks in attempting to comply with the ANSI standard.

Mr. **Kaminski**. Well, the endorsement is not an automatic selection. You have to manually fix the machine to endorse in that specific area. So when you're in a high-speed processing area, handling millions of checks a day, you're attempting to clear checks for a dollar availability and you may miss some deadlines.

Mr. **Hatch**. Madam Chairman, if I could also answer in regard to that question—and it must be understood that the return check process is a manual process. Pulling out that item and identifying the endorsement and making a decision about it is part of the cost and difficulty inherent in the problem.

Senator **Hawkins**. I'm glad you brought that up. To speed the forward trip of checks from depository banks to payor banks, the industry developed a high speed, highly automated process relying on machine-readable transit numbers. Why haven't you developed a similar system for returns?

Mr. HATCH. It's very easy going one way because the money is there. Coming the other way is a lot more difficult because you have to actually manually read those items that are rejected. A computer will typically tell you the accounts that are overdrawn on that day and the clerk must then go and physically remove the checks from all the others that have been processed to get those to an officer for the decision process. The officer then has to make a decision.

What the bill is asking us then for identification cost as well as the normal return decision process and then put that back in the system, and what Mr. Kaminski is describing is the problems of reading that endorsement on the back of the check because it could have been through any number of different processors en route. You could conceivably get right back to the bank of first deposit and then there's the check itself and then it's a question of how do you get the money back. If the money came through six different banks or four different institutions or the Fed or whatever, it's one thing to get the check back to the original institution, but that money went through three or four different places en route.

Senator HAWKINS. How do you get the money back?

Mr. HATCH. It now goes back through the chain through which it came.

Senator HAWKINS. Eventually going to the person who wrote it?

Mr. HATCH. That's correct. Somebody deposits it in my bank and it's drawn on a bank in California, for example, my bank might deposit it in a local clearinghouse and the local clearinghouse is going to deposit it through the Fed system to whoever the California bank uses, and then back to the California bank. That's the way the money went and that's the way it's got to come back.

Senator HAWKINS. How fast does it go, the forward trip?

Mr. HATCH. The forward trip is usually within 2 days, maybe 3.

Senator HAWKINS. Even though it went through three banks?

Mr. HATCH. Even though it may be three banks. Senator, as you're aware, the industry has indeed spent a lot of money and developed sophisticated systems in order to move checks as rapidly as possible.

Senator HAWKINS. That's true, and I believe that the testimony we have here today shows that there should be some spent in expediting the backward trip also.

Mr. Kaminski, if the ANSI standard were used, what would you view the next logical step toward a faster check return system?

Mr. KAMINSKI. Well, I believe that the pilot program that's taking place in Dallas, the standard would be able to help that type of an operation. One of the other objectives of the standard was to improve the readability of those two most important endorsers to allow some pilots to be more successful.

Senator HAWKINS. Would the system apply to all the checks or just some?

Mr. KAMINSKI. It would apply to all the checks that would go through high-speed check processing equipment.

Senator HAWKINS. Thank you very much. Senator Dodd had asked that several of those be asked of you, Mr. Kaminski.

One of the most disturbing aspects of all of this is some banks refuse to give immediate credit on the deposit of Government checks and that works a particular hardship on retirees and Government benefit holders in my State.

Why don't banks give immediate credit on these items, Mr. Hatch?

Mr. HATCH. Most banks do, as I understand it. You bring up an interesting problem, though, the difference between the electronic system and the paper-based system. There is an electronic system where those people can receive their money and have it absolutely on the day it's due without question. It's a direct deposit which the Government has offered and the banks cooperate in it.

The fact that the senior citizens and other recipients of Government checks don't want that system indicates the extent of the problems that we're having. We can talk about the availability of sophisticated electronic systems, but until the consumer is going to use them, it works both ways. All of those people who are having problems getting their checks deposited could indeed have direct deposit on their Government payments but many people don't choose to use that service.

Senator HAWKINS. They really don't trust you, you understand?

Mr. HATCH. I don't know whether it's me or the Government.

Senator HAWKINS. It's a combination and I know many, many senior citizens who wait and wait for that check. I happen to know one Congressman's mother who calls the Congressman if her check is 1 day late. This is her son. Her other son works for me and I get the call the next time and we happen to know about this and we cannot talk her into direct deposit. She wants to see that actual piece of paper. That's historical with people over 65 years of age. It's a nice trip for her to go into the bank to see the banker and to deposit the check. I don't understand why banks won't give immediate credit to the person when he deposits a Government check.

Mr. HATCH. Most banks do, especially when it's a regular customer. If it's a new customer there might be some problems, but I see those people in my bank every third of the month and it's a good social hour and they enjoy it and obviously there's no problems with the vast majority of them.

Senator HAWKINS. We have a similar problem with cashiers checks and certified checks. Most people get a cashier's check in connection with a house sale or a move. They feel that's cash, with proper ID, but in many cases it is not.

Can you justify such a practice of not honoring checks like that?

Mr. HATCH. I think it goes to what Vice Chairman Martin said about the question of fraud. There is evidence of abuse in that area. I think it goes back to what you and I were just discussing, Senator. There are electronic means to transfer those funds and yet somehow people don't want to use them. One can wire funds to cover a house payment or transfer funds in that manner and we're all familiar with the problem of buying houses or whatever, and there are ways to accomplish that.

Senator HAWKINS. Both California and New York have passed laws regulating delayed funds availability policies. What problems do you anticipate the industry will have under those laws, Mr. Hatch?

Mr. HATCH. I think the biggest problem is being passed on to the consumers and that is obviously going to be an increased level of risk in dealing with certain circumstances. If it's a new account or an unknown customer or a difficult business, I think that under those circumstances that is going to get passed on as a cost back to the depositors in some form or other.

As far as the operational question, I think we will see increased losses from checks being returned and, of course, that is a significant problem in smaller institutions. There are instances where banks have failed because they have had their capital severely impaired by large dollar items being returned.

Senator HAWKINS. More than one witness has suggested this is a national problem to be best controlled at the Federal level rather than the State-by-State policy. Do you agree with that assessment?

Mr. HATCH. No, I don't. I think that, given time, within the constraints we've talked about ——

Senator HAWKINS. You would rather have 50 policies than 1?

Mr. HATCH. I don't think that we will. I think what we've seen in initial State legislation is in States where there's large urban populations that may require it more than in the vast rest of the country, and if there are those problems that those States feel they need to address, then I would think that would be appropriate. I don't think on the national level, given the voluntary effort that's in progress, coupled with the kind of things the regulators said to you earlier with their willingness to look harder at it than perhaps even in the examination process.

VOLUNTARY REFORM NEEDED OR FEDERAL LEGISLATION COMING

Senator HAWKINS. They look at it, look at, look at it, and then study it and study it and study it. So if this subcommittee acts on legislation, would you prefer to see broad general norms with a delegation to the Federal Reserve Board to issue implementing regulations or to have a law with specific requirements on disclosure, endorsements, and clearing time?

Mr. HATCH. None of the above.

Senator HAWKINS. None of the above. It may be all of the above.

Mr. Falls, how do you feel about that, coming from California, one of these States with large urban areas? You're No. 1, I guess, and I see that the 1990 census will make Florida No. 3 next to California and Texas. So I guess we're next in line. How do you feel about that?

Mr. FALLS. The check cashing system is a national system. One of the dangers we were concerned about was nobody in the State of California would accept a Connecticut check if it were passed in its original form. And you go through some of the consequences of that and you go down to the supermarkets today and you say no out-of-State checks accepted. Well, banks are going to have that problem and that could be one of the consequences of badly drafted legislation in some of the States.

Mr. **Hatch**. If I might say it, Senator Hawkins, it was probably no accident that Mr. Falls stumbled in his testimony when he tried to mention Truth-in-Lending. It's a classic example of well-intended legislation gone awry. We're all aware of the problems. All we wanted to do initially 15 years ago was simply tell the consumer what he was being charged for his loan. As you know, it's one of the most complex code of Federal regulations we now have. It was a Freudian slip.

Senator **Hawkins**. But you're not opposed to Truth-in-Lending?

Mr. **Hatch**. I'm not opposed at all to Truth-in-Lending, but somehow the enactment of that simple idea has turned into a nightmare as far as implementation.

Senator **Hawkins**. That's usually what happens when it has to be done at the Federal level instead of at the local level, or more importantly, by the industry.

Mr. **Hatch**. I guess what is happening now with the focus being given this issue, I strongly suspect we will see a lot more attention being given to that on the local and national level.

Senator **Hawkins**. And hopefully by the industry itself.

Mr. **Hatch**. Correct, on a voluntary basis.

Senator **Hawkins**. So we wouldn't have any at all. That's the best of all worlds.

Mr. Falls, is part of the problem the use of the remote payor banks by corporations to gain float?

Mr. **Falls**. Speaking for the Bank of America——

Senator **Hawkins**. Just for yourself.

Mr. **Falls**. Yes, I believe it is part of the problem, but not the whole problem. What's happening here is we are beginning to become more diversified as consumers get more sophisticated in their cash management debt needs. One of the problems originated with the money market funds when they started issuing checks, which their customers used all over the country. These same customers used to keep their funds in the local bank. If the balance was OK, no holds were placed. Now there's no balance. These funds are all outside of the banks in cash management accounts with checks drawn from California to New York. This situation has accelerated the problem, in my opinion.

Senator **Hawkins**. Plus the new personal computer that is coming down the line. Everybody has their own computer at home just like the bank has. Is that going to have some impact on this?

Mr. **Falls**. It could have a positive impact. The more we move away from paper-based systems to electronics, as long as protections such as security remain in place, the more it's going to improve the payment system nationally.

Mr. **Hatch**. Again, Senator, if I might comment in that regard, it goes back to where those electronic systems are. They still are in their infancy and if there is consumer acceptance of them, as you mentioned earlier in your discussion with Vice Chairman Martin about check safekeeping in the banks and the banks wanting to keep the checks and not returning them, and your own personal reaction to that. There's an example.

Senator **Hawkins**. Do you know who likes them more than me? The IRS.

Mr. **Hatch**. That's right. We used to say a cancelled check is your receipt. Now we've got to swallow those words and use something different. But it does illustrate the problem of getting a change in consumer attitudes toward using new electronic systems.

Senator **Hawkins**. I do thank you gentlemen for helping us today with this legislation. Despite years of study and despite the availability of ways to reduce delay on check processing, the Federal Reserve and the banking industry have moved at a snail's pace in taking steps to reform the check clearing system to shorten holds on checks.

I think this hearing has indicated that the banks have little incentive to speed the return process because it would cost money and the banks would lose their float.

This hearing illustrates the need for a uniform Federal policy that would require disclosure of institutions hold policies; require uniform, readable endorsements; and time limits on holds.

I'm seeking the best ways to achieve these goals and I hope that the industry and the Federal regulators will move faster. Maybe this hearing will provide an incentive for them to pick up their pace a little bit because if more action is not forthcoming, I can guarantee you that Federal legislation will be forthcoming. Thank you very much.

The hearing is adjourned.

[Whereupon, at 12:05 p.m., the hearing was adjourned.]

[Additional material supplied for the record follows:]

USL
UNITED STATES LEAGUE of SAVINGS INSTITUTIONS WASHINGTON OFFICE
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ROY G. GREEN
Executive Vice President

September 25, 1983

The Honorable Paula Hawkins
Chairwoman, Subcommittee on
Consumer Affairs
Banking, Housing and Urban
Affairs Committee
313 Hart Senate Office Building
Washington, D. C .20510

Dear Senator Hawkins:

The U. S. League of Savings Institutions* welcomes this opportunity to present its views with respect to S.573, The Fair Deposit Availability Act. We believe that deposit hold policies are necessary to prevent excessive loss to financial institutions offering NOW accounts, demand accounts and other deposit accounts. Moreover, our analysis shows that under the current deposit hold system few customers are denied access to funds because of deposit holds. Very few customers' checks are returned because they draw on funds still subject to a deposit hold.

Ultimately, the solution to any concern consumers may have regarding delayed access to deposited funds is to eliminate, as much as possible, the need for the customer to physically deposit checks to his account. This can be accomplished if customers are able and willing to have checks of all types -- payroll, government, dividend, etc. -- deposited electronically to their accounts. Such funds would be immediately available. However, the availability and consumer acceptance of electronic direct deposit in the United States currently lags far behind that of other industrialized nations.

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* The U. S. League of Savings Institutions, formerly the U. S. League of Savings Associations, has a membership of 3,500 companies representing over 99% of the assets of the $730 billion savings and loan business. League membership includes all types of associations -- Federal and state-chartered, stock and mutual. Recently, many prominent savings banks have joined the League as members. The principal officers are: Leonard Shane, Chairman, Huntington Beach, California; Paul Prior, Vice Chairman, New Castle, Indiana; William O'Connell, President, Chicago, Illinois; Stuart Davis, Legislative Chairman, Beverly Hills, California; and Roy Green, Executive Vice President, Phil Gasteyer, Legislative Counsel, Jim Freeman, Senior Legislative Representative, Washington, D. C. League headquarters are at 111 East Wacker Dr., Chicago, Illinois 60601. The Washington Office is located at 1709 New York Avenue N. W., Washington, D. C. 20006. Telephone: (202) 637-8900.

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Why Savings Institutions Use Deposit Holds

Savings institutions place deposit holds on deposited checks to reduce the risk that they will incur a loss when honoring customers' checks drawn on these funds. Such a loss can occur when the institution pays out funds represented by the deposited check only to find that the check is returned unpaid by the institution on which it is drawn. If this occurs, the institution incurs a direct loss unless it is reimbursed by the customer.

Savings institutions and other financial institutions must be particularly concerned about deliberate attempts of individuals to commit fraud by the practice known as "kiting" or by depositing stolen, forged or bogus checks.

Losses can also be incurred without a customer's initial deliberate attempt to defraud an institution if the customer has withdrawn the funds represented by a deposited check and is then unable or unwilling to reimburse the financial institution when the deposited check is returned unpaid.

Savings institutions generally utilize deposit holds to focus their security procedures in areas which present the greatest risks of loss. The institution conversely, seeks to avoid inconveniencing customers by not enforcing holds when the risk of loss is minimal. The mitigating effect of such selective policies is apparent by examination of actual statistics for items returned because of drawing on held funds.

Impact of Deposit Hold Practices of Savings Institutions

Although most savings institutions place holds on checks deposited by customers, the effect is of little consequence to most customers. This is demonstrated by the finding of a recent 1982 survey conducted by the U. S. League of 67 savings institutions which supplied information with respect to their deposit hold practices concerning NOW accounts. The survey respondents represented institutions ranging in asset size from $50 million to $4 billion and operating in market areas ranging in size from small towns to very large metropolitan areas.

First, it should be emphasized that deposit holds rarely affect the interest earned on funds the customer deposits to a NOW account. Whether or not they place a hold on a deposited check, most savings associations pay interest on such funds from the date they are deposited. Moreover, the customer earns interest on these funds even though the institution may have to wait as much as a week to receive the proceeds of the check in a form which allows the institution itself to begin earning income on the funds.

Thus, the customer benefits from the savings institution practice of paying interest from date of deposit. In doing so, savings institutions, in turn, avoid the operating and customer relations problems that would occur if earnings credits were delayed until the institution itself had received investable funds from the collection of such deposited checks.

With respect to the effect of deposit holds on customer access to funds, the survey data shows that the number of checks savings institutions return unpaid because of drawing on held funds is very low. For example, respondents to the survey reported that during January 1982 the frequency with which customer checks were returned for drawing on held funds was as follows:

	Customer Checks Returned Drawing on Held Funds per 100,000 Checks Processed		
Market Area Population	Average Number	Average Percent	Number of Respondents
Metropolitan (1,000,000+)	66	0.07%	13
Metropolitan (100,000 to 1,000,000)	26	0.03%	31
Small town and suburban	27	0.03%	14

Detailed analysis of the statistics shows that 50% of institutions serving smaller communities returned no checks because of deposit holds during the entire month of January. During this period, nearly 25% of those serving large metropolitan areas also reported not returning any checks because of deposit holds.

Clearly, the percentage of customer checks returned for drawing on held funds is very low. Furthermore, considering that approximately 1% of all customer checks are returned for all reasons, checks returned for drawing on held funds represent only about 1/20th of the total number returned. Therefore, it is evident that deposit hold policies of savings institutions have relatively little effect on the ability of customers to draw on funds deposited to NOW accounts.

Because deposit hold policies are not rigorously enforced, savings institutions do incur some losses as a result. During 1981, a period when most survey respondents first began to offer NOW accounts, institutions serving large metropolitan areas wrote off an average of approximately $0.71 per NOW account per year because of paying customer checks that drew on uncollected funds. Institutions serving metropolitan areas of less than 1,000,000 in population incurred losses averaging $0.67 per NOW account per year. Institutions serving small communities incurred considerably smaller losses. Thus, the nature of the market area has a great deal to do with the care that must be exercised in dealing with checks deposited by customers.

Generally, larger losses were associated with relatively liberal hold policies. For example, one large institution that, as a policy, did not return any items drawing on held funds, experienced a loss of more than $2.00 per NOW account during 1981 because of paying these items.

Prior to reviewing in detail deposit hold practices of savings institutions generally, it would be appropriate, at this juncture, to comment on specific provisions of the Fair Deposit Availability Act of 1983.

Current Legislation

The current version of S.573 imposes many unreasonable restraints upon depository institutions. The most onerous provision of the legislation is contained in Section 6. This Section provides:

> "Not later than 24 hours after a payor depository institution determines not to pay a check or similar instrument of $250 or more it shall directly notify the depository institution at which the check was originally deposited of such non payment."

This expedited notice requirement for items of $250 more that are returned would impose an enormous workload on financial institutions. Large check processors would be faced with literally thousands of calls each day to institutions on which the checks are drawn. Since there are more than 23,000 depository institutions which would be involved in this process, the potential impact of such a requirement is significant.

Implementation of Sectin 6 would raise the following issues: (1) Who at each institution would one call? (2) Would the institution receiving the call be willing to act on the information received by telephone? (3) Who would bear the expense of the call? We believe that this Section would impose burdensome and confusing requirements on depository institutions. This section should be eliminated from the Bill.

Section [illegible] provides that "each depository institution should maintain its endorsement on checks and other items described in regulations of the Board [Federal Reserve Board] in a position provided for in the endorsement standard (ANSI X-9.3-1981) or in regulations of the Board."

This requirement for compliance with the ANSI-endorsement standard is unrealistic since, to our knowledge, neither the manufacturer of the endorsement equipment nor the processors of the checks are able at this time to provide clean, clearly-legible endorsements as required by the standard. Accordingly, this requirement should be eliminated from the legislation.

Section 3 contains a series of disclosure requirements. While the U. S. League does not oppose disclosure requirements, it appears that the various financial institution regulatory agencies could encourage depository institutions to disclose deposit practices without the passage of this legislation.

However, the adoption of Section 3 does raise certain problems. It could increase the possibility of check fraud since depository institutions would be required to disclose deposit hold practices. Knowledge that an institution places, for example, a two-day hold on a particular class of checks would make the perpetration of check fraud even easier.

We do not oppose the requirement of Section 4 mandating that depository institutions may not delay computing interest on funds beyond the date on which it receives a provisional credit for the check. It should be noted, however, that we are unaware of any savings institutions which engage in the practice of delaying earnings on deposits. The marketplace competition would readily correct for any perceived problems with credited earnings. Moreover, the administrative complexity of figuring out effective deposit dates would discourage institutions from engaging in this practice.

Finally, we believe that the civil liability attached to failure to perform under this legislation is extremely severe. The penalties for non-compliance are clearly disproportionate to the nature of the violation. The failure to comply with comparable provisions of various statutes would rarely lead to problems for the public that warrant penalties as severe as those in Section 9 of the Bill. Further, it appears that the potential for lost business from the failure to provide good customer service is sufficient penalty for excessively lengthy hold practices.

Detailed Review of Deposit Hold Practices of Savings Institutions

While the effect of deposit hold policies is primarily defined by the degree to which the customer is actually denied access to funds, a summary of savings institution deposit hold policies may also be of interest to the subcommittee. A description of such policies includes how the length of deposit holds is determined, the length of hold applied to various categories of checks, adequacy of deposit holds, the exceptions made in applying holds, the percentage of deposits actually held and the policy for handling a customer check reported as drawing on held funds.

1. How the Length of Deposit Holds Is Determined

The length of a deposit hold is determined by the period of time required for the savings institution to be reasonably confident that a deposited check forwarded for collection will not be returned unpaid. This period is governed by the number of processing points in the check collection system through which a check must pass in order to be presented to the institution on which it is drawn. These are also the points through which it must pass in reverse order if the check is dishonored by the drawee institution.

As institution can estimate how long it should take for a particular class of deposited checks (e.g., checks drawn on local institutions, checks drawn on out-of-state institutions, etc.) to be presented to the drawee institution and returned to the institution if dishonored. This estimate can be made making an assumption about the probable route the item will take through the check collection system and also assuming that all institutions handling the item will observe the processing deadlines established by the Uniform Commercial Code (UCC). However, as discussed below, the actual time taken for checks to be returned is likely to exceed the theoretical clearance and return time and therefore some additional time must be allowed.

2. Length of Deposit Holds Employed by Savings Institutions

The actual number of processing points through which an item passes for collection and subsequent return is somewhat related to the distance between the savings institution where the item was deposited and the institution on which it is drawn. For this reason, savings institutions typically classify deposited checks into three groups: (1) those drawn on local institutions; (2) those drawn on institutions outside the local area but within the state; and (3) those drawn on institutions out of state. (The exact nature of the market area and check clearing patterns may make it appropriate for an institution to use a somewhat different classification.)

Most institutions designate the hold period in terms of calendar days which automatically allows for weekends when checks would normally not be processed. (In the following discussion of hold periods, institutions expressing hold periods in business days have been converted into equivalent calendar days.)

The median hold period assessed for various categories of deposited checks by savings institutions in different market areas is shown in the following table:

	Length of Deposit Hold in Calendar Days of Median Institution* by type of Item and Market Area		
Type of Item	Metropolitan: 1,000,000+	Metropolitan: 100,000 to 1,000,000	Small Town and Suburban
Local	4	4	4
Within state, non-local	7	7	6
Out-of-State	9	11	11

* Half of the respondents had shorter and half had longer hold periods.

As the table shows, the length of the hold period is related to the distance the item must travel to get to the institution on which it is drawn. The nature of the market area in which the institution is located appears to make little difference to the length of hold imposed for various classes of items. The one exception is that institutions in large metropolitan areas appear to use shorter holds for out-of-state items. This, perhaps, reflects the fact that such institutions have more direct access to the large correspondent banks typically involved in clearing such items.

3. Adequacy of Deposit Holds: A Case Study

As stated previously, institutions can estimate the hold period based on the probable flow of the item through the check collection system and the processing deadlines established under the UCC. In actual practice, however, the time required for the item to be presented and returned can significantly exceed this estimate.

A three-week survey of return items made by a New York savings institution showed that the number of days between the date the association forwarded the check for collection and the date the returned check was received almost always exceeded the hold period, and usually by a significant number of days.

For example, while the association uses the equivalent of a seven-day hold for items drawn on institutions in metropolitan New York, only 1% of checks returned by local institutions were received within the seven-day hold period. About 90% took at least 10 days to be returned, 54% took at least 13 days, and 10% took more than 15 days.

The association had a similar experience with items drawn on institutions outside of the metropolitan area. For these items, the association uses the equivalent of an 11-calendar-day hold. About 10% of these return items were received within 11 calendar days. About 60%, however, required at least 16 days to be returned and 10% took at least 20 days to be received.

Based on this experience, the institution could justify lengthening its hold period. To be 90% certain that a return items will be received before the hold expires, the institution would have to lengthen the hold period on local items from seven days to 15 days while the hold period on out-of-town items would have to be lengthened from 11 days to 20 days.

Informal comments of other savings institutions suggest that the experience of this institution is not unusual. What may be happening is this:

--- While large-dollar checks being returned are handled expeditiously to avoid being challenged by a claim of late return, return items for small amounts may be handled with less urgency.

--- Handling of return items is still a costly, time-consuming, manual process. Therefore, resources may first be concentrated on large-dollar items being returned and then applied to any backlog of small items remaining to be handled.

--- Participants in the check collection system seem to accept this practice as a realistic way to hold down costs while allowing the system to operate in a reasonably smooth and efficient manner.

4. Conditions Under Which Deposit Holds Are Waived

Savings institutions, as they have competed with banks for NOW account customers, have been mindful of the need to avoid antagonizing customers with unreasonable hold policies. Thus, many institutions will waive holds under certain conditions. For example, at least two-thirds of institutions will waive holds for deposits of government checks, well-recognized payroll checks and cashier's checks. A similar proportion will waive holds on deposits made by established customers. Thus, only a portion of deposits are actually subject to a hold.

5. Percentage of Deposits Actually Held

For the typical institutions, only about one-third of deposits are actually held. This reflects the effect of exemptions made for certain types of checks deposited and for established customers. But, even if deposits are held, the actual effect of the deposit hold can only be established based on what happens when a customer's check is reported as drawing on held funds.

6. Policy for Handling Checks Drawing on Hold Funds

More than 90% of survey respondents will review the situation when an item is reported as drawing on held funds. The institution will look at the number of days before the hold expires, whether the customer has other account relationships, and how the customer has handled his checking account. Unless the circumstances are unfavorable, the institution is likely to pay the item rather than return it. Less than 10% of respondents automatically return checks drawing on held funds.

Improving Customer Funds Availability Will Require Fundamental Changes in the Payments System Rather Than Changes in Deposit Hold Policy

Based on the survey data reported above, it does not appear that NOW account customers of savings institutions are being disadvantaged by deposit holds. Because savings institutions are new entrants into this market and are motivated to increase their market share, most have been careful to avoid antagonizing customers by indiscriminate enforcement of deposit holds. In any event, the hold periods which are employed may, in fact, be inadequate due to the manner in which the check collection system actually deals with return items.

Any attempt to regulate a reduction in length of deposit holds will mean that institutions will be increasingly vulnerable to losses. If institutions incur greater costs because shorter hold periods increase losses due to checks drawing on uncollected funds, these costs will be passed along to all customers, most of whom are not responsible for this increase in costs.

The one change to the payments system that will improve funds availability to consumers without increasing costs is expansion of electronic direct deposit of payroll, dividend and government checks. Such deposits represent immediately available funds to the customer since the institution gets good funds at the same time as it receives the information about the customer's deposit.

Perhaps the solution to eliminating delays in availability of customer funds is to find a way to encourage both business and consumers to accept direct deposit. If direct deposit were more widely accepted, it is possible that both cost and efficiency gains would benefit all.

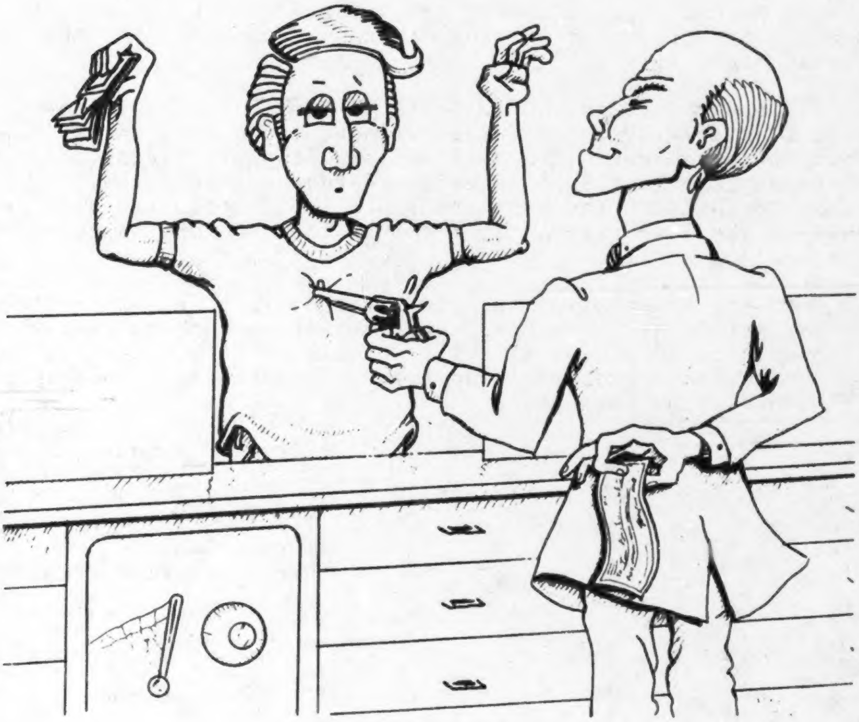
Very truly yours,

Roy G. Green

Roy G. Green
Executive Vice President

ALE:tm

BANK HOLD UP REPORT



FPIRG
Florida Public Interest Research Group
226 W. Pensacola St. Tallahassee, FL 32301

BANK HOLD-UP REPORT

Ross Williams
Senior Organizer
October 1983

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Summary and Recommendations

According to the Federal Reserve, most deposited checks are credited to banks within 48 hours. Despite this, many customers find their funds held up by the bank for much longer periods.

FPIRG has surveyed banks and savings and loans in seven counties. Almost all the institutions included in the surveys reported having formal check holding policies. These policies ranged from one to twenty-two banking days depending on the bank and origin of the check.

Generally, local checks are held from 3 to 7 banking days; instate checks from 5 to 10 days; and out of state checks from 10 to 15 days (See Appendix 1). The longest hold was 23 days on some out-of-state checks by one Savings and Loan. Only one bank reported it provided its customers access to their funds as soon as the bank was credited with them. Most banks did report some flexibility in their policies. Many had classes of checks which were exempt or provided exemptions for certain customers.

Banks have these policies to protect themselves from losses that may occur from returned checks. However, the actual losses that occur do not appear to be substantial. Some banks may be using hold policies to increase funds available for loans. This seems verified by figures indicating banks make more off of "float" than they lose from bad checks.

Regardless of the reason for holding a check, the practice places a hardship on customers. Further research is needed to determine what the effects of these policies are and who is effected. It is clear from reports in Florida and other states that some bank customers have been inconvenienced, frustrated and embarassed as a result of their banks check hold policies.

Some states, notably California, have passed legislation limiting check holds. Florida should pass such legislation. It should provide that:

- Banks and Savings and Loans must make funds deposited by check available to their customers within a reasonable length of time.
- A reasonable length of time will be presumed to be when the funds are available to the bank or five banking days, whichever is less.
- Customers must be informed if a hold is placed on funds and the reason for such a hold.

Legislation, with their provisions, would eliminate blanket holds on checks while still allowing a bank to hold questionable checks.

Check Collection Process

The check collection process in the U.S. is highly mechanized. Using computerized sorting, banks move a check relatively quickly from the bank where it is deposited to the bank on which it was drawn. Fifty-one percent[1] of all checks are deposited to accounts at the same bank on which they are drawn. The remaining 49% may go through several intermediary banks to get from the collecting bank to the paying bank. In 1969, the average check passed through 2-6 banks.[2] Each bank handling a check, provides credit to the previous bank, endorses the check, and sends it to the next bank. This entire process takes from one to six days.[3] The usual time is less than two days.[4]

Once the check arrives at the paying bank, the process is reversed if the check is returned. This process is not mechanized and typically takes twice as long to complete as the original routing. Each bank must read the endorsements on the check to determine the bank from which it received the check and return it to that bank by midnight of the next business day.[6]

Check Holds

It is the slow process for returning checks which banks say make lengthy hold policies necessary. Since banks are never notified if a check is honored, check hold times are set to allow enough time for the bank to hear if a check was dishonored. While banks receive credit for the funds within 72 hours, that credit is provisional and is revoked if the check is returned.

Cost of Returned Checks

The number of checks actually returned is approximately 1 in every 100.[7] Insufficient funds or closed accounts are the reason for approximately 80% of the returns.[8] Of these, the Federal Reserve estimates one in ten is never made good.[9] Thus less than one in one-thousand checks ever go uncollected by the bank.

The actual dollar losses to banks from uncollectable checks is minimal. A 1974 Bank Administration Institute study estimated banks lose $500 million each year on returned checks. According to the study over half of these losses resulted from obliterated endorsements, late returns or checks that were lost. Losses from these causes are unaffected by check holding policies.

Profits to Banks

Funds which are available to the bank but not its customers, known as "float", can be extremely profitable to the bank. According to Time Magazine,[10] Lee Falls, vice-president of San Francisco's Bank of America, says his bank earns $3.35 million from "float" each day. Figures for the entire banking industry are difficult to obtain. It is clear, however, that check holds are profitable to the bank. This is true regardless of their value as protection from returned check losses.

Impact on Customers

More information is needed on the impact check holding policies on bank customers. Problems that have been reported include:

- Small businesses unwilling to accept checks from their customers.
- Customer checks "bounced" for "uncollected funds" causing the customer embarassment and bad check charges.
- Students unable to pay tuition because their parent's check is on hold.
- Housing purchases delayed because the check from a previous sale is being held.

While it is hard to know how widespread such problems are, a study by the Federal Reserve indicates one in ten banking customers report being either inconvenienced or seriously affected by check holds. However, only 38% of the banks in that survey had formal policies on check holds. In Florida, where hold policies appear more common, problems to customers are likely to be more common.

FOOTNOTES

1. Allison, Theodore; Staff Director for Federal Reserve Bank Activities, Board of Governors of the Federal Reserve System; Testimony before the sub-committee on Consumer Affairs; Committee on Banking, Housing and Urban Affairs; U.S. Senate, March 10, 1982.
2. Bank Administration Institute; Return Item Notification Procedures. A Task Force Report 1979, page 8.
3. Allison, Theodore; etc.
4. Luck, Tom; Federal Reserve Board of Governors, Bank Operations Division, Conversation August 3, 1983.
5. Allison, Theodore; etc.
6. Bank Administration Institute, page XI.
7. Luck, Tom; etc.
8. Bank Administration Institute, page 3.
9. Luck, Tom; etc.
10. Time Magazine; May 16, 1983.
11. Allison, Theodore; etc.

APPENDIX I

CHECK HOLD POLICIES - BROWARD & PALM BEACH COUNTY SAVINGS & LOAN

	Hold On Checks		
Banks	Local	Instate	Out of State
American	7 Days	14 Days	14 Days
Amerifirst Federal	7 Days	15 Days	15 Days
Atlantic Federal	5 Days	5 Days	5-14 Days
Biscayne Federal	7 Days	12 Days	12 Days
Carteret	5 Days	10 Days	10 Days
Citizen's Federal	10 Days	20 Days	20 Days
Coral Gables Federal	7 Days	14 Days	15 Days
Financial Federal	7 Days	7 Days	14 Days
First Federal of Lake Worth	7 Days	10 Days	14 Days
First Federal of the Palm Beaches	5 Days	10 Days	12 Days
First Nation-Wide	8 Days	0-10 Days	0-10 Days
Flagler Federal	7 Days	14 Days	14-23 Days
Glendale Federal	7 Days	14 Days	14 Days
Home Federal (City Fed.)	10 Days	10 Days	21 Days
Home Savings of America	5 Days	7-10 Days	0-20 Days
Peninsula Federal	10 Days	16 Days	16 Days
Sunrise Savings	5 Days	5 Days	10 Days
United Federal	7 Days	14 Days	14 Days
Hollywood Federal	5 Days	10 Days	10 Days
City Federal	7 Days	7 Days	15 Days

CHECK HOLD POLICIES - BROWARD & PALM BEACH COUNTY BANKS

Banks	Hold On Checks Local	Instate	Out of State
Atlantic National of Broward	4 Days	4 Days	10 Days
Atlantic National of Palm Beach	4 Days	4 Days	7-10 Days
Barnett Bank	5 Days	5 Days	12 Days
Colonial Trust Company	1-4 Days	4 Days	4-12 Days
Consolidated	5 Days	10 Days	10 Days
First American Bank & Trust	5 Days	7 Days	12 Days
First Bankers of Palm Beach Co.	3 Days	5 Days	5 Days
Florida Coast Bank Deer Creek	4 Days	4 Days	10 Days
Florida Coast Bank of Palm Beach Co.	4 Days	10 Days	10 Days
Florida National	5 Days	10 Days	15 Days
Landmark First National of Ft. Lauderdale	2-3 Days	5 Days	10 Days
North Carolina National Bank	3 Days	4 Days	8 Days
Royal Trust of Palm Beach	4 Days	5 Days	6-10 Days
Southeast	5 Days	7 Days	10 Days
Southern	5 Days	7 Days	10-14 Days
Sun Bank (Century)	5 Days	5 Days	7 Days

CHECK HOLD POLICIES - DADE COUNTY BANKS
With 1-2 Branches

	Hold On Checks		
Bank	Local	Instate	Out of State
Central Bank of North Dade	6 Days	6 Days	12 Days
Coconut Grove Bank	4 Days	8 Days	8-21 Days
Executive National Bank	4 Days	8 Days	8 Days
Great American Bank at Dade County	4 Days	8-10 Days	8-10 Days
International Bank of Miami	4 Days	4-6 Days	8 Days
North Carolina National Bank	1 Day	1 Day	2 Days
Popular Bank of Florida	5 Days	5 Days	10 Days

CHECK HOLD POLICIES - DADE COUNTY BANKS
With 3-6 Branches

Bank	Hold On Checks Local	Instate	Out of State
Central Bank & Trust Company	4 Days	6-7 Days	8-10 Days
City National Bank of Miami	4 Days	10 Days	14 Days
County National Bank of North Miami Beach	4 Days	8 Days	8 Days
Eagle National Bank of Miami	4 Days	4-6 Days	4-12 Days
National Bank of Florida	4 Days	8 Days	12 Days
Pan American Bank of Dade County N.A.	4 Days	7 Days	10 Days
Republic National Bank	5 Days	7 Days	15 Days
Safra Bank	5 Days	8 Days	10-14 Days

CHECK HOLD POLICIES - DADE COUNTY BANKS
With 7 or More Branches

	Hold On Checks		
Bank	Local	Instate	Out of State
Atlantic National Bank of Miami	4 Days	7 Days	10 Days
Bank of Miami	3 Days	5 Days	8-10 Days
Barnett Bank of South Florida	5 Days	5 Days	10 Days
Capital Bank	5-6 Days	6-8 Days	6-15 Days
Consolidated Bank N.A.	4 Days	6 Days	10 Days
Florida National Bank of Miami	7 Days	12 Days	16 Days
Royal Trust Bank of Miami	4 Days	7-9 Days	10-15 Days
Southeast Bank N.A.	4 Days	5-6 Days	8-10 Days
Sun Bank of Miami	5 Days	6 Days	Varies
United National Bank of Miami	5 Days	10 Days	10 Days

CHECK HOLD POLICIES - LEON COUNTY BANKS AND SAVINGS & LOAN

	Hold On Checks		
Banks	Local	Instate	Out of State
Barnett Bank	3 Days	5 Days	10 Days
Citizens Commercial	3 Days	5 Days	10 Days
City National	3 Days	5 Days	East West 10 Days 15 Days
Ellis National Bank	3 Days	5 Days	10 Days
First National Bank	3-4 Days	7 Days	10 Days
Flagship Bank	3 Days	5-7 Days	15 Days
Florida State Bank	3-5 Days	5-7 Days	7-10 Days
Industrial National Bank	7 Days	10 Days	15 Days
Lewis State Bank	3 Days	5 Days	10 Days
Marine State Bank	3 Days	6 Days	10 Days
North Florida National Bank	3 Days	5 Days	7-10 Days
Second National Bank	3 Days	5 Days	10-14 Days
Southern Bank	3 Days	7 Days	14 Days
Andrew Jackson Savings and Loan	3 Days	7 Days	7-10 Days
Florida Federal Savings and Loan	3 Days	3 Days	7 Days
Pioneer Federal Savings and Loan	3 Days	7 Days	14 Days
Security First Federal Savings and Loan	3 Days	5 Days	10 Days
Sun Federal Savings and Loan	7 Days	15 Days	15 Days

CHECK HOLD POLICIES - HILLSBOROUGH COUNTY

Banks	Hold On Checks Local	Instate	Out of State
Atlantic Bank	3 Days	5 Days	10 Days
Sun Bank	4 Days	7 Days	9-12 Days
Barnett Bank	6 Days	10 Days	15 Days
North Carolina National Bank	0-4 Days	0-4 Days	0-4 Days
Southeast Bank	2-3 Days	Varies	0-10 Days
First National of Florida	1 Day	4-6 Days	8-14 Days
Ellis Bank	3 Days	5 Days	12 Days
Pan American Bank	4 Days	7 Days	10 Days
Peoples' Bank	5-7 Days	7-10 Days	21 Days
University State Bank	5 Days	8 Days	10 Days
Columbia State Bank	3 Days	5 Days	10 Days
Flagship Bank	3 Days	5 Days	10 Days
Citrus Park Bank	4 Days	4 Days	8 Days
Landmark Bank	5 Days	7 Days	14 Days
Independent Bank	5 Days	7 Days	10 Days
United First Federal Savings and Loan	3 Days	5 Days	10 Days
Savings and Loan			
United First Federal	10 Days	15 Days	21 Days
Glendale Federal	5 Days	10 Days	10 Days
Freedom Savings	1 Day	3-4 Days	8-10 Days
Sunshine State Federal	5 Days	7 Days	11 Days
Florida Federal	3 Days	5 Days	10 Days
First Home Federal	5 Days	10 Days	20 Days

APPENDIX II

AMENDED IN ASSEMBLY MAY 25, 1983
AMENDED IN ASSEMBLY MAY 3, 1983

CALIFORNIA LEGISLATURE—1983–84 REGULAR SESSION

ASSEMBLY BILL No. 1723

Introduced by Assemblyman Willie Brown
(Coauthors: Assemblymen Agnos, Alatorre, Areias, Calderon, Clute, Condit, Connelly, Farr, Goggin, Hauser, Hayden, Isenberg, Katz, Killea, Klehs, Mojonnier, ~~Molina, Moorhead, O'Connell, Vasconcellos, and Maxine Waters)~~ *Molina, Moore, Moorhead, O'Connell, Papan, Stirling, Vasconcellos, Maxine Waters, and Norman Waters)*
(Coauthors: Senators Alquist, Bill Greene, Leroy Greene, Montoya, Petris, and Rosenthal)

March 4, 1983

An act to amend Section 4213 of the Commercial Code, and to add Article 1.8 (commencing with Section 866) to Chapter 7 of Division 1 of the Financial Code, relating to financial institutions.

LEGISLATIVE COUNSEL'S DIGEST

AB 1723, as amended, W. Brown. Banks.

Existing law provides that, subject to any right of the bank to apply the credit to an obligation of a customer, credit given by a bank for an item in an account with its customer becomes available for withdrawal as of right when a provisional settlement for an item received by the bank becomes final and the bank has had a reasonable time to learn the settlement is final.

This bill would eliminate these provisions and would provide instead that credit given by a bank for an item *deposited* in an account with its customer becomes available for withdrawal as of right within a reasonable time after the item has been deposited in an account with its customer and forwarded by the bank for collection. A reasonable time would be presumed to be when the ~~item is paid~~ *bank receives a provisional credit* or within 5 banking days, whichever occurs earlier.

~~Existing law provides that a deposit of money in a bank is final when made but, subject to any right of the bank to apply the deposit to an obligation of the customer, the deposit becomes available for withdrawal as of right at the opening of the bank's next banking day following receipt of the deposit.~~

~~This bill would instead provide that the deposit becomes available for withdrawal as of right by the close of the same banking day.~~

The bill would also provide that prior to the opening of a ~~transaction~~ *deposit* account, a depository institution, as defined, shall provide a written disclosure to the potential customer of its general policy with respect to when a customer may withdraw funds deposited by check or other similar instrument into the customer's deposit account, as defined. The bill would make related changes and provide for civil liability for a violation of those provisions.

Vote: majority. Appropriation: no. Fiscal committee: no. State-mandated local program: no.

The people of the State of California do enact as follows:

SECTION 1. Section 4213 of the Comercial Code is amended to read:

4213. (1) An item is finally paid by a payor bank when the bank has done any of the following, whichever happens first:

(a) Paid the item in cash.

(b) Settled for the item without having a right to revoke the settlement under any of the following: statute, clearinghouse rule, agreement, or reservation thereof.

(c) Settled for the item having a right to revoke the settlement under any one or more of the following: statute, clearinghouse rule, agreement or reservation thereof, and failed to revoke the settlement in the time and manner permitted under such right.

Upon final payment under paragraphs (b) or (c) the payor bank shall be accountable for the amount of the item.

(2) If provisional settlement for an item between the presenting and payor banks is made through a clearinghouse or by debits or credits in an account between them, then to the extent that provisional debits or credits for the item are entered in accounts between the presenting and payor banks or between the presenting and successive prior collecting banks seriatim, they become final upon final payment of the item by the payor bank.

(3) If a collecting bank receives a settlement for an item which is or becomes final (subdivision (3) of Section 4211, subdivision (2) of this section) the bank is accountable to its customer for the amount of the item and any provisional credit given for the item in an account with its customer becomes final.

(4) Subject to any right of the bank to apply the credit to an obligation of the customer, credit given by a bank for an item *deposited* in an account with its customer becomes available for withdrawal as of right:

(a) Within a reasonable time after the item has been deposited in an account with its customer and forwarded by the bank for collection. A reasonable time for purposes of this section is presumed to be when the ~~item is paid~~ *bank receives a provisional credit* or within five banking days, whichever occurs earlier.

For purposes of this section, more than five banking days after receipt of the deposit is presumed to be a manifestly unreasonable time ~~to learn that the settlement has been revoked or become final~~.

(b) In any case where the bank is both a depositary bank and a payor bank and the item is finally paid—at the opening of the bank's second banking day following receipt of the item.

(5) A deposit of money in a bank is final when made but, subject to any right of the bank to apply the deposit to an obligation of the customer, the deposit becomes available for withdrawal ~~by the close of the same banking~~

~~day.~~ *as of right at the opening of the bank's next banking day following receipt of the deposit.*

SEC. 2. Article 1.8 (commencing with Section 866) is added to Chapter 7 of Division 1 of the Financial Code, to read:

Article 1.8. Disclosure of Delayed Availability Policy

866. As used in this article:

(a) "Depository institution" means any of the following:

(1) Any insured bank as defined in Section 3 of the Federal Deposit Insurance Act (12 U.S.C. Sec. 1811 et seq.) or any bank which is eligible to make application to become an insured bank under Section 5 of the act.

(2) A mutual savings bank as defined in Section 3 of the Federal Deposit Insurance Act (12 U.S.C. Sec. 1811 et seq.) or any bank which is eligible to make application to become an insured bank under Section 5 of the act.

(3) A savings bank as defined in Section 3 of the Federal Deposit Insurance Act (12 U.S.C. Sec. 1811 et seq.) or any bank which is eligible to make application to become an insured bank under Section 5 of the act.

(4) An insured credit union as defined in Section 101 of the Federal Credit Union Act (12 U.S.C. Sec. 1751 et seq.) or any credit union which is eligible to make application to become an insured credit union pursuant to Section 201 of that act.

(5) Any member as defined in Section 2 of the Federal Home Loan Bank Act (12 U.S.C. Sec. 1421 et seq.).

(6) Any insured institution as defined in Section 401 of the National Housing Act (12 U.S.C. Sec. 1701 et seq.) or any institution which is eligible to make application to become an insured institution under Section 403 of that act.

(b) "Deposit account" means an account in a depository institution on which the account holder is permitted to make withdrawals *from time to time in person* by negotiable or transferable instrument, payment orders of withdrawal, telephone transfers, or other similar items for the purpose of making payments or transfers to third persons or others. The term includes demand deposits, negotiable order of withdrawal draft accounts, savings deposits subject to automatic transfers, share draft accounts, and all savings deposits and share accounts, other than time deposits.

866.2. (a) Prior to opening a ~~transaction~~ *deposit* account a depository institution shall provide a written disclosure to the potential customer of its general policy with respect to when a customer may withdraw funds deposited by check or similar instrument into the customer's deposit account.

(b) A depository institution shall furnish its customers preprinted deposit slips, or envelopes for automatic teller machine deposits, bearing a conspicuous summary statememt of its general policy with respect to when a customer may withdraw funds deposited by check or similar instrument into the customer's deposit account; ~~or~~ *and,* in the case of a particular deposit by check or similar instrument into a deposit account for which funds may not be immediately available for withdrawal, provide specific notice of the time the customer may withdraw such funds.

866.3. For the purposes of computing the amount of interest or dividends payable with respect to an interest-bearing deposit account, a depository institution shall not delay beginning to compute interest on funds deposited by check or similar instrument to such an account beyond the date on which that depository institution receives provisional credit for the check or similar instrument. However, the payment of interest with respect to funds deposited by check or similar instrument which is returned unpaid shall not be required.

866.4. Except as otherwise provided in this section, any depository institution which fails to comply with any requirement imposed pursuant to this article shall be liable to the aggrieved party in an amount equal to the sum of any actual damage sustained by the person as a result of the failure; and, in the case of an individual action an additional amount as the court may allow, except that the amount shall not be less than fifty dollars ($50) nor greater than five hundred dollars ($500); or, in the case of a class action, such amount as the court may allow, except that as to each member of the class no minimum recovery shall be applicable, and the total recovery in any class action or series of class actions arising out of the same failure to comply by the same depository institution shall not be more than the lesser of five hundred thousand dollars ($500,000) or 1 percentum of the net worth of the depository institution; and, in the case of any successful action to enforce the foregoing liability, the costs of the action, together with a reasonable attorney's fee as determined by the court.

In determining the amount of award in any class action, the court shall consider, among other relevant factors, the amount of any actual damages awarded, the frequency and persistence of failures of compliance, the resources of the depository institution, the number of persons adversely affected, and the extent to which the failure of compliance was intentional.

A depository institution may not be held liable in any action brought under this section for a violation of this article if the violation was not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid any such error. Examples of a bona fide error include, but are not limited to, clerical, calculation, computer malfunction and programming, and printing errors. An error of legal judgment with respect to a person's obligations under this article shall not constitute a bona fide error.

Any action under this section may be brought in any court of competent jurisdiction, within one year from the date of the occurrence of the violation.

No provision of this section imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule, regulation, or interpretation thereof by the Federal Reserve Board or in conformity with any interpretation or approval by an official or employee of the Federal Reserve System duly authorized by the board to issue interpretations or approvals under such procedures as the board may prescribe therefor, notwithstanding that after any act or omission has occurred, the rule, regulation, interpretation, or approval is amended, rescinded, or determined by judicial or other authority to be invalid for any reason.

APPENDIX III

Figure A-8
Causes for Return Item Losses

Reason	No. of Items Written Off	Percent of Total Items	Dollar Value of Write Off	Percent of Dollars Written Off
Late return to depositors	61	4	11,996	5
Missing or inadequate endorsements	91	5	14,329	6
Obliterated endorsements	598	36	96,981	39
Funds not available in account	806	48	111,125	45
Lost returns	111	7	12,651	5
TOTAL	1,667	100%	247,082	100%

Source: *Impact of Exception Items on the Check Collection System*, Park Ridge, Ill., Bank Administration Institute, 1974.

APPENDIX IV

FPIRG BANK and SAVINGS & LOAN CONSUMER SUREVEY

NAME OF BANK or S&L ______________________________

YOUR NAME ______________________ PHONE # __________

1. How many branches does this bank have? ______________

   In what locations? ______________________________

2. Do the branches use any other name(s)? What? ____________

3. Do all branches have consistent policies? ______________

   What are the differences? ______________________

4. What is the minimum deposit for opening a regular checking

   account? ________ For an interest checking account? ________

5. What service charges are there for regular checking? ________

6. What service charges are there for interest checking? ________

7. What is the minimum balance for free regular checking? ______

8. What is the minimum balance for free interest checking? _____

9. What is the interest rate for interest checking? __________

   How often is it compounded? ______________________

10. What is the charge for bad checks? ____________________

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11. How long is the hold on deposited checks? (in business days)

Instate ________ Local _________ Out-of-state _____________

Will you return for insufficient funds a check drawn on

these funds? _______________ Are any checks exempted from

your policy for holding deposited checks? __________________

12. Do you offer money market savings? _______ Checking? _______

13. What is the savings interest rate? ___________________________

How often is it compounded? _________________________________

14. What are your hours? ______________________________________

15. Do you have a 24 hour teller? _______________ How many? ____

16. Was this survey clear? ______ Do you have any suggestions for
how it could be improved in the future?

____

____

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____

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